

# **JOINT SELECT COMMITTEE ON PUBLIC SCHOOL FINANCE**



**Report to the 78<sup>th</sup> Legislature**

**December 2002**

JOINT SELECT COMMITTEE  
ON PUBLIC SCHOOL FINANCE

77th Legislature

Sen. Teel Bivins  
Co-Chair  
Sen. Steve Ogden  
Sen. Florence Shapiro  
Sen. Eliot Shapleigh  
Sen. Leticia Van de Putte  
Sen. Royce West

Public Members  
Kent Caperton  
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Rep. Paul Sadler  
Co-Chair  
Rep. Harold Dutton  
Rep. Kent Grusendorf  
Rep. Scott Hochberg  
Rep. Rene Oliveira  
Rep. Todd Smith

December 9, 2002

The Honorable Bill Ratliff  
Lieutenant Governor  
Members of the Texas Senate  
State Capitol Complex  
Austin, TX 78711

The Honorable James E. "Pete" Laney  
Speaker of the House  
Members of the Texas House of Representatives  
State Capitol Complex  
Austin, TX 78768

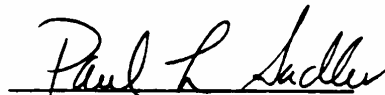
Dear Governor Ratliff, Speaker Laney, and Members of the Texas Senate and House of Representatives:

The Joint Select Committee on Public School Finance is pleased to submit its final interim report for consideration by the 78<sup>th</sup> Legislature.

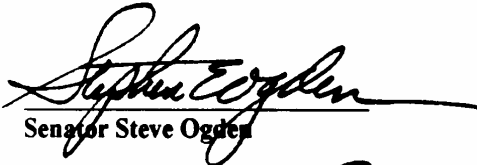
Respectfully submitted,



Senator Teel Bivins, Co-Chair

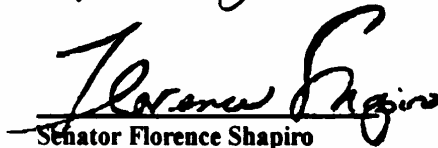


Representative Paul Sadler, Co-Chair




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Representative Todd Smith

  
The Honorable Kent Caperton

  
The Honorable Lyndon Olson

  
The Honorable Will Davis

  
The Honorable Mark Stiles

  
Mr. Craig Foster

  
Mr. David Thompson

# Chapter One

## Acknowledgements

The Committee is deeply indebted to the following persons for their input and assistance with this report: Bill Alloway, David Anderson, John Augenblick, James LeBas, David Dunn, Billy Hamilton, Harrison Keller, Dick Lavine, Ursula Parks, Ray Perryman, Steve Smith, Uri Triesman, Bernard Weinstein, Joe Wisnoski, the staff of the Attorney General, and the many House and Senate staff members who contributed their time, effort, and analysis to this process. Additionally, the Committee is grateful for the input and suggestions of citizens from across the state. Without the collaboration of these people, this report would not have been possible.

## Chapter Two

### Executive Summary

The Joint Select Committee on Public School Finance was created to conduct a comprehensive review of the public school finance system in Texas. Co-Chaired by Senator Teel Bivins and Representative Paul Sadler and composed of 18 members (six Senate, six House and six public members), this Committee was faced with a large, complex and difficult task. Issues of programs, funding formulas, system structure, equity, adequacy, cost, revenue resources, including review of the state's tax system, were all brought before the Committee and discussed by members of the public, state experts and national experts.

The historical context of this issue and the forces driving the current system to capacity are intricate and often symbiotic. Each layer of the system is interwoven with constitutional and judicial requirements, not to mention the more obvious requirements of the day to day maintenance of an enormous public education system. This system, by its nature and due to its prioritization by the public via the Legislature, is the single largest expenditure in the state budget.

Property taxes have been a component of state revenue systems nationwide for much of this country's history. Texas first enacted a property tax in 1837. Since then and through numerous modifications, this type of taxation has become the single most significant source of local revenue in the state. While a state property tax is unconstitutional, local taxing jurisdictions, and most importantly for purposes of this report, school districts, depend on the property tax for much of their revenue.

In the mid 20th century, Texas and most other states adopted a "minimum foundation school funding system". This approach to funding public schools relies on a partnership between the state and local school districts for funding education. In almost all cases, local school districts have only one way to raise money- the property tax. As the differences in taxable property among local school districts became more and more pronounced, Texas and the vast majority of other states in the U.S. experienced law suits claiming that the dramatic differences in the ability to raise money from property taxes due to differences in property wealth created an unconstitutional system. The plaintiffs succeeded in almost every case.

Soaring property taxes during the 1970's were the catalyst for a major revision of the property tax code of Texas in 1979. As a result, all property taxed by school districts is appraised by a single county appraisal district, and those appraisals are used by every taxing jurisdiction in that county, including school districts. State standards were implemented and state supervision of local tax offices was required.

While this new system of property taxation was deemed better than previous systems, it still left the issue of disparities in property wealth unsettled. In the 1982-83 school year the first Edgewood lawsuit was filed based on the concept that the existing two-tier system did not compensate for these disparities. Texas' current system of funding public schools was adopted in 1993 and in 1995 was determined by the courts to be constitutional. It required the state to redistribute property tax revenues from property wealthy districts to poorer districts, ensuring substantially equal revenues for substantially equal property tax effort. This decision did not, however, define the level of state funding needed for equity, but instead stated that the current system met the court's threshold.

The state's existing school funding system presents significant challenges to Texas in that it is overly reliant on property taxes and the notion of recapture is unpopular. Because the funding system equalizes the revenue-generating capacity of all school districts, it reduces the role of local property wealth in determining the level of funding available for individual schools. The state's significant gains in student achievement made in the last ten years are at least partially attributed to the equity principles inherent in the system.

This plan has been called "Robin Hood" because of its reliance on recapture of revenues from property wealthy districts and its redistribution of those funds to poorer districts. It should be noted that this plan was adopted by the Legislature only after numerous other attempts to achieve a constitutional funding system had been struck down by the Texas Supreme Court.

Since 1995, the state has seen rising property values and even more rapidly rising costs due to population growth, inflation, and numerous other variables. While public education continues to be the single largest expenditure in the state budget, as a percentage of total funding, state funding has lagged further and further behind local revenues as the primary source of education funding statewide. This is in spite of many billions of state dollars being pumped into the system to provide property tax relief, teacher pay raises and school district employee health insurance. The ever growing over-reliance on local property taxes to fund public education is the impetus behind this study and while numerous proposals for a system overhaul or change to the current system have been proposed, it is ultimately up to the 78th Legislature to determine how best to approach this issue.

This report gives an overview of complete plans for systemic change, in other words, plans for change of the entire chassis of the system, and breaks out changes that could be made separately or as components of a larger plan to be developed by the next Legislature. Persons offering plans for an entirely new "chassis" were Lt. Governor Ratliff, Senator Florence Shapiro, Mr. Craig Foster, Mr. David Thompson and Mr. Lynn Moak.

Proposed changes to the component parts of the system included moving to a single tiered system, creating automatic cost of living adjustments, increasing the number of students in the equalized system, using current year property values and locally adopted

tax rates in state aid calculations, changing current programs and funding weights, updating the Cost of Education Index, allowing a more flexible school year and local budgeting, improving facilities funding and increasing per capita spending over all.

To pay for proposals that were predicted to cost the state more money, Committee members heard testimony concerning closing franchise tax loopholes, creating a voluntary or a mandatory state income tax, raising the \$1.50 local property tax cap, creating a split tax base, revising the current tax exemptions, creating penalties for failure of businesses to comply with mandatory rendition, requiring property sales price disclosure, increasing professional licensing fees and the number of professions' charged fees, and restructuring recapture. A full review of the current tax system was provided to members by the staff of the State Comptroller's office, and a full review of the state's legal taxing authority was provided by the staff of the state's Attorney General.

Chairman Sadler stated that the reason that Texas' "Robin Hood" plan has not been replaced is because no one has come forward with a silver bullet since 1993. The reality is that as long as Texas relies on a "minimum foundation school funding system," wholesale change will be difficult. This and the fact that the state is faced with budgetary constraints in the next biennium comprise the framework on which this Committee structured this report. The report lays out a menu of options for the next Legislature to consider in whole or in part as it addresses the ever increasing burden on local property tax bases to fund public education.

## Chapter Three

### The Charge

The Committee Shall:

1. Conduct a comprehensive review of the public school finance system in Texas, including, the system's structure, being sure to address issues of facilities, transportation and similar issues; the method of funding for public schools in the state; and factors that determine how to pay for education (e.g. personnel costs vs. student attendance, course completion, classroom vs. distance learning).
2. Consider all equity issues affecting school districts and the school finance system.
3. Examine fully the revenue resources for funding public schools, including a review of the state's tax system as it relates to public school finance.

### Introduction

The charge to the Joint Select Committee on Public School Finance was composed of three components and driven by the realization on the part of legislators that reliance on local property taxes to fund public education is too great. The charge directed the Committee to conduct a comprehensive review of the public school finance system, including transportation, facilities, and other similar issues. The method of finance was also to be examined; meaning not just the use of property taxes, but the entire tax system of the state as it relates to the support of public education. The Committee was further charged to consider how to pay for personnel costs, course completion, student attendance and distance learning.

The Committee endeavored to meet this challenge by holding hearings around the state, taking both public and invited expert testimony. The testimony clearly made the case for a more flexible funding system, with greater funding capacity that does not over-rely on local property taxation. While efficiency and the general diffusion of knowledge are constitutional requirements more than a century and a half old, the Committee learned that the contemporary interpretation of those requirements changes almost daily due to the ever increasing numbers of students, the demands of new technology and changing demographics. Another factor impacting the equity issue and the 1995 Edgewood ruling is the amount of local enrichment currently outside the equalized system.

The roots of the current debate go back to 1949, when the Gilmer-Aiken Act created what is today's Foundation School Program. That Act used personnel units to fund the state's share of the cost of public education. Over the years the state's share of the cost has fluctuated, and today, in spite of billions of dollars of increased spending by the state, the



local share of the total cost exceeds the state's. Rising costs have created a greater reliance on local funding. Local property taxes now fund more than 50% of the total cost of public education from a statewide perspective.

Over time, disparity in property wealth among districts created a situation in which property poor districts could raise less per student at higher tax rates than property wealthy districts. This situation became the basis of multiple lawsuits seeking funding equity among all districts in the state. When the courts found the state's funding system to be unconstitutional, multiple legislative attempts to address the issue led to what is today's equalized, recapture-based system. While lauded by many as one of the most equitable school finance systems in the nation, new lawsuits question whether rising local property taxes have created an unconstitutional statewide property tax. The question has also been raised as to whether rapidly rising local tax rates have created such an enormous strain that they now jeopardize the capacity of the system itself. Thus, this Committee was constituted to address system capacity and issues related to financing public education in Texas.

The Appendices of this report contain a great deal of witness testimony and resource material provided to the Committee. However, due to the volume of materials provided to the Committee, only materials directly referred to in this report are included. All other resource materials and written testimony provided to the Committee during this process are available for review through the Senate Education Committee.

## Chapter Four

### **Public Testimony**

The Joint Select Committee on Public School Finance traveled to six cities across Texas, Amarillo, El Paso, Brownsville, Galveston, Price, and West Lake, to hear public testimony on public school finance. The testimony underscores the statewide belief that the over-reliance on property taxes is a critical issue in public school funding. All of the submitted written testimony is available through the Senate Education Committee. As noted in the previous chapter, due to the volume of testimony, it is not included in this report.

### **Expert Testimony Summary**

The Joint Select Committee on Public School Finance held a number of hearings in Austin with invited testimony. A number of expert witnesses testified. Their written testimony, as presented to the Committee, is available through the Senate Education Committee.

### **TEA Public School Finance Seminar**

David Anderson and Joe Wisnoski of the Texas Education Agency were invited to testify before the Joint Select Committee on Public School Finance on October 24, 2001. Below is a brief summary of their testimony.

- Annual state and local aid exceed \$24 billion. The two largest sources are local M&O taxes (\$13.5 B) and the state foundation funding (\$9.5 B).
- Almost all money in the system is geared to overcome disparities in local property values. Any change tends to impact the equity of the entire system.
- Higher property values result in savings in state general revenue. Higher tax rates increase state cost and local budgets. The opposite also applies to both.
- An increase of one student on average raises the cost of the Foundation School Program about \$5,500. An increase of \$1 billion in tax base generally reduces state aid by about \$15 million. An increase in tax rate of \$.01 raises the total Tier II amount by \$132 million, and costs an additional \$46 million in state aid.

- 77th Legislature Major Formula Changes  
 Guaranteed level of \$25.81 in 2001-02  
 Guaranteed level of \$27.14 in 2002-03  
 Equalized wealth level of \$300,000 in 2001-02  
 Equalized wealth level of \$305,000 in 2002-03  
 Gap aid
- Chapter 41 equalization options  
 Voluntary consolidation  
 Detachment/annexation  
 Purchase attendance credits from state  
 Educate non-resident students  
 Tax base consolidation
- Funding Rules  
 Adjustments in prior year property values  
 Local tax effort  
 Biennial lag in recognizing tax effort  
 Chapter 41 Hold Harmless provisions  
 Facilities funding limits

## **The Texas School Finance System: An Outline Summary of Legal Challenges and Constitutional Standards**

Jeffrey Boyd, Deputy Attorney General for Litigation, was invited to testify before the Joint Select Committee on Public School Finance on October 25, 2001. Mr. Boyd testified on the history of legal challenges to public school finance in Texas. Below is a brief summary of his testimony.

### **1949 Gilmer-Aiken Act**

Created a minimum foundation program to equalize state aid by a guaranteed amount per student; allowing for local enrichment.

### **1971 *Rodriguez v. San Antonio I.S.D.***

Property-poor districts challenged a system that encouraged districts to develop special education programs with matching state funds, saying that only wealthy districts could afford to participate. The district court agreed that the system violated equal protection guarantees in U.S. Constitution.

### **1973 *Rodriguez v. San Antonio I.S.D.***

The U.S. Supreme Court reversed the district court's 1971 ruling, finding that the state system bore a rational relationship to furthering state goals of providing minimum education while encouraging local control.

### **1989 Edgewood I**

Property-poor districts challenged inequity in funding under the Texas Constitution. The Supreme Court ruled the system was neither financially efficient nor efficient in providing a ‘general diffusion of knowledge.’ Under a constitutional system, districts must have substantially equal access to similar revenues per pupil at similar levels of tax effort and local enrichment must derive solely from local tax effort.

### **1991 Edgewood II**

In response to Edgewood I, the 71st Legislature adopted SB 1, with the goal of ensuring similar yield for similar tax rates and created adjustments in funding to address gaps between districts. The Supreme Court ruled that SB 1 did not remedy the major causes of the wide opportunity gaps between rich and poor districts. A funding system that is so dependent on local property taxes must draw revenue from all property at a similar rate. The Court suggested changing district boundaries, consolidation of districts, and consolidation of tax bases as possible remedies.

### **1992 Edgewood III**

The 72nd Legislature, through HB 351, established 188 County Education Districts comprised mostly of school districts within a single county, giving them the sole duty to levy, collect, and distribute property taxes. The state set the tax rate and directed how the proceeds would be distributed. The Supreme Court held that HB 351 created an unconstitutional state ad valorem tax.

### **1995 Edgewood IV**

The 73rd Legislature, through SB 7, created the current system, which requires recapture from districts with property values above a certain wealth per weighted student. The Supreme Court upheld this system. Efficiency requires substantially equal access to funding up to the legislatively defined level that provides an accredited education. Efficiency does not prohibit local enrichment.

### **2001 *West-Orange Cove Consolidated I.S.D. v. Nelson***

Wealthy districts sued the Commissioner of the Texas Education Agency, alleging they had lost the discretion to set Maintenance and Operations tax rates since they would soon be at the \$1.50 cap, which, they argued, creates a state ad valorem tax. Defendants pled that no district must tax at \$1.50 to provide a general diffusion of knowledge/accredited education. The trial court dismissed the case, finding that not enough districts were at the cap.

### **2001 *Hopson v. Dallas I.S.D.***

Taxpayers sued districts where they resided, alleging that the system imposes a state ad valorem tax and that the use of Weighted Average Daily Attendance (WADA) in determining equalized wealth level is in violation of the Texas Constitution. Defendant Irving I.S.D. filed a third party petition against the Commissioner of Education.

## **Case Update**

Since Jeffrey Boyd's testimony the Texas Court of Appeals, Third District, affirmed the judgment in *West Orange-Cove Consolidated I.S.D. v. Nelson*. It held that West Orange-Cove's pleadings simply fail to state a viable cause of action because they did not claim that the district is forced to tax at the highest allowable rate to provide the bare, accredited education. "Accredited education" has been used by both the Legislature and the Supreme Court to define "general diffusion of knowledge." The Court also held that the claim is not ripe because the plaintiff districts failed to show that they were forced to set tax rates at the maximum rate just to provide an accredited education. The trial courts finding that not enough districts had reached the taxing cap did not correctly state the relevant test for ripeness.

There has been no decision in *Hopson v. Dallas I.S.D.* Other school finance cases have been filed in the state but the state is not a party to those suits.

## **Funding K-12 Education**

Mr. Steve Smith, from the National Conference of State Legislatures, was invited to testify before the Joint Select Committee on Public School Finance on October 25, 2001. Mr. Smith testified on public school finance in Texas. Below is a brief summary of his testimony.

### **Revenue and Funding Structures in Texas**

- State funding is approximately 48% of total funding.  
(General Revenue Fund, lottery, education trusts)
- Local Funding is approximately 45% of total funding.  
(Property tax, local sales tax, fees)
- Federal funding is approximately 7% of total funding.  
(Title I, IDEA grants)

### **Changes in Funding Structures**

- In 1993, Michigan eliminate local school property taxes and voters choose a replacement that: Increased state sales tax 2%, created a 6 mil state property tax (prior to passage, average millage rate was 34), created a 12 mil local property tax on non-homestead property, reduced state income tax .2%, and increased tobacco taxes.
- In 2001, Minnesota changed to a foundation level system. The state funds the entire foundation level and local districts can levy an additional \$800 per pupil.

## **Distribution of Funds**

- All states provide funding for education through finance formulas and/or categorical funds and require local support in order to receive state funding.
- States that require certain local effort usually have a foundation program (local district required to levy a certain millage rate for equalization). Many states multiply the foundation level by a weight for certain students.
- Facilities funding is distributed through formulas, matching funds, separate construction oversight agencies and state loans to districts.
- State funding is delivered via special education funding, pupil weights, reimbursement, and census based funding.
- Twenty-seven states rank schools/districts and over 30 states reward/sanction schools/districts.
- New requirements from the General Accounting Standards Board (GASB) give states responsibility to identify best financial practices.

## **Thorough, Efficient, and Equitable Systems**

- In defining a “thorough and efficient” system, a state must define the cost of the system, determine the source of funds and require equitable distribution.
- The state’s role is to specify performance standards, measure whether they are being accomplished and hold students/teachers/schools accountable for the results; supply sufficient resources for schools to be successful.
- Policymakers in some states are attempting to develop a link between performance and spending.

## **Litigation Surrounding Education Finance**

- The standards based movement has influenced the move toward adequacy.

## **A Study of Uncontrollable Variations in the Costs of Texas Public Education**

Dr. Uri Treisman from the Charles A. Dana Center was invited to testify before the Joint Select Committee on Public School Finance on January 24, 2002. Dr. Treisman testified on uncontrollable variations in the costs of Texas public education. The text below was provided to the Committee by the Dana Center.

The Charles A. Dana Center was charged by the 76<sup>th</sup> Legislature to conduct a study of variations in known resource costs and costs of education beyond the control of a school district. This report contains a short description of updating the existing CEI. It also examines several education cost-adjustment models, as well as the potential total impact on the Foundation School Program of applying each of these models to existing school finance formulas. Finally, this report provides an overview of issues to consider in adopting a new Texas CEI.

**SECTION 1:** The Dana Center conducted a series of formal interviews with officials from twenty-seven school districts to determine the financial pressures they face. In these interviews, some issues were raised repeatedly, regardless of the size and location of the school district. Some issues were raised only by certain types of districts (different size, location). Section 1 also contains a brief history of education cost adjustments in Texas and a short discussion of adjustments to school district funding in other states.

**SECTION 2:** The CEI is the mechanism that Texas uses to adjust Foundation School Program calculations to compensate for variations in resource costs and uncontrollable costs of education. The CEI affected the distribution of approximately \$1.23 billion in state aid to school districts during each year of the 1999–2000 biennium. The CEI adjusts funding to school districts based on five uncontrollable factors that include average competitive salary for beginning teachers, location in a county with a population of less than 40,000, percentage of pupils that are low-income, district type, and district size.

Every Texas school district is assigned a CEI value between 1.00 and 1.20, which is used to adjust foundation program calculations for both Tier 1 and Tier 2 of the Foundation School Program. The existing CEI, however, has not been updated since its adoption in December 1990, which means that roughly thirteen percent of all state aid to school districts is currently distributed on the basis of a ten-year-old analysis of school district expenditures.

Two points illustrate the limitations of the existing Cost-of-Education Index. First, the existing CEI only includes the uncontrollable factors that were found to have an impact on teacher salaries in 1990. Second, the existing CEI leaves out several factors that affect the cost of hiring teachers. In addition, significantly more data is available now than was available when the existing CEI was constructed in 1990. An updated CEI would have a range of index values from 1.03 to 1.23 and would require a total annual increase in state aid to school districts of between \$296 million and \$368 million. On the average, major urban districts and major suburban districts would be the primary beneficiaries of updating the existing CEI. A few regions would receive somewhat less state aid than they would under current law. It is important to note, however, that this analysis is based on the assumption that the updated CEI would be applied to the Foundation School Program in the same way that the existing CEI is applied. The updated CEI can easily be made revenue-neutral by adjusting the percentages in the current finance formulas to which the CEI is applied.

### **SECTION 3:** Three alternative approaches to creating a new Texas adjustment.

**Texas Wage Indices:** A series of wage indices designed to capture variations in the general cost of doing business in Texas, including a Professional Industries Index, a Professional Occupations Index, a Financial and Service Industries Index, and an All Industries Index. The analysis revealed that a Financial and Service Industries Index does a slightly better job than the other indices of predicting the salaries of teachers, administrators, and support staff and seems to be the most credible choice for a wage index that would reflect market wages for education.

The principal advantage of a wage index as an adjustment strategy is that it avoids the difficult problems associated with distinguishing controllable variations in school district expenditures from those that are uncontrollable. A potential disadvantage of the wage index is that it draws on wage and salary information for non-teachers and may not fully reflect the actual market for teachers faced by Texas school districts.

The wage index would be the most expensive alternative to implement, requiring a total annual increase in state aid to school districts of about \$4.7 billion. The largest projected increases would be for districts in metropolitan areas. Ultimately, the wage index represents a good measure of what it would cost public schools to be competitive other groups competing for highly qualified college graduates.

**Texas Teacher Salary Indices:** Because teacher salaries are the largest component of school district expenditures, this section presents salary indices designed to reflect the uncontrollable factors that influence the salaries teachers are willing to accept from school districts. Unlike the existing CEI, the teacher salary indices approach the question of teacher compensation from the perspective of salaries teachers are willing to accept. Two different salary index models exist. The *baseline* model incorporates all of the measurable factors that we have identified as important determinants of salaries teachers are willing to accept. The *essentials* model incorporates only a subset of the student, district, and community characteristics from the baseline model. There are separate essentials models for urban and rural school districts. The essentials salary index would adjust funding to school districts based on eleven uncontrollable factors that were found to have a significant impact on the costs of education. Every Texas school district is assigned an index value between 1.000 and 1.281 for the essentials salary index and between 1.00 and 1.34 for the essentials salary and benefits index.

The principal advantage of these salary indices is that they offer the greatest potential for a new adjustment that is both fair and easy to implement in the context of current school finance formulas. There are three principal disadvantages to these salary indices. First, there is a risk that important factors have been omitted from the salary indices analysis. A second disadvantage is the difficulty in distinguishing between controllable and uncontrollable costs. A third disadvantage is that all these indices are designed to capture local variations in the price of labor, which is only one part of uncontrollable cost variations.



The essentials teacher salary index would result in a total annual decrease in state aid to school districts of approximately \$88 million. Major urban districts and major suburban districts would receive a moderate annual increase in total state aid and on the average, total state aid to other types of districts would be reduced. The essentials salary and benefits index would require a total annual increase in state aid to school districts of approximately \$510 million. Almost every school district would receive an increase in state aid, although small rural districts would experience a moderate decrease in annual state aid.

**Cost-Function Index:** The cost-function index is designed to capture variations in the costs to districts of producing a given level of educational outcomes, given the costs districts must pay and the environmental factors that districts face. Because of significant overlap with the purpose of other adjustments, such as the Small District and Mid-Sized District Adjustments, it would not be advisable simply to replace the existing CEI with cost-function index values in the current school finance formulas. A more appropriate approach would be either (1) to estimate cost-function index values which could be used in combination with some or all of the current school finance formulas; or (2) to use the cost-function index values as the sole adjustment to the Basic Allotment in Tier 1 of the Foundation School Program and to much of the Tier 2 Guaranteed Yield Program. If the cost-function index were applied to the Foundation School Program in a manner that would provide all districts with at least their current levels of Tier 1 and Tier 2 funding, the projected annual cost to the state would be approximately \$493 million.

The cost-function index is a more comprehensive index than the existing CEI, the wage index, or the salary indices. Constructing a cost-function index that reasonably describes educational practices in Texas involves identifying the relevant prices of inputs, environmental factors, and measures of educational outcomes. A disadvantage of the cost-function index discussed in this report is that the analysis has been limited by a lack of data on nonlabor inputs and on educational outcomes.

### **Other Issues to Consider in Adopting a New Texas Cost Adjustment**

**Application to the Foundation School Program.** The existing CEI is applied to seventy-one percent of the Basic Allotment, and the impact of fifty percent of the effects of the CEI is applied in determining a district's count of students in Weighted Average Daily Attendance. The Legislature may wish to explore the modification of these percentages in adopting a new CEI.

**Transition Mechanisms.** An important issue to consider pertains to mechanisms to ease the transition from one adjustment to another. Under each of the education cost indexing strategies, some school districts would experience reductions in state aid.

**Periodic Updating.** Districts' index values have not been updated since the existing CEI was adopted in 1990. In our research, we found that many districts have changed significantly since then. Furthermore, it was determined that the existing index leaves out several factors that have an impact on the cost of hiring teachers. To avoid these issues in

the future, the state should consider periodic updating of any new adjustment with current data, and the state should periodically reexamine the index methodology to ensure that the index continues both to capture appropriate cost factors and to reflect district conditions appropriately.

## **Texas School Finance and Real Estate Values Reliance on Property Tax May Damage Real Property Owners**

Malcolm Richards from the Real Estate Center at Texas A&M University was invited to testify before the Joint Select Committee on Public School Finance on January 25, 2002. Dr. Richards testified on real estate values and how they affect the Texas school finance system. Below is a brief summary of his testimony.

The Texas school finance system imposes a heavy burden on Texas homeowners. Texas school property taxes have expanded from \$2.8 billion in 1980 to \$13.6 billion in 2000, a 367.1 percent total increase, equal to an 8.5 percent compounded annual increase. Property taxes act as a drag on the value of real estate and increasing tax burdens ensure a negative influence on real estate values. These burdens can influence land use decisions as owners seek to avoid or reduce tax liabilities. A cost effective public school finance system should enhance property values. Location in a preferred school district is an important determinant of home value.

Demographic experts predict an expanding student population base. The composition of that population will include an ethnic shift, increasing the percentage of students from Hispanic households. Many of those Hispanic students will come into the public school system speaking English as a second language. Texas faces a growing challenge to provide resources to meet the educational needs of this expanding segment of its student population. These factors may require an increase in spending to properly educate every public school student.

With an escalating need for more funding and an increasing reliance on local property taxes to fund public education, the already high property tax burden on Texas real estate will increase. During a sluggish economy, residential property appreciates more rapidly than business property, shifting the tax burden from business to homeowners. Increased tax burdens could influence property owners to seek more exemptions and abatements, challenge real estate values, and look for methods to avoid the tax.

## **Demographic Trends in Texas: Implications for Public School Financing**

Dr. Bernard Weinstein from the Center for Economic Development and Research at the University of North Texas was invited to testify before the Joint Select Committee on Public School Finance on January 25, 2002. Dr. Weinstein provided data on the

implications of demographic trends for public school financing in Texas. Below is a brief summary of his research.

- Texas population changes

|          | 1990       | 2000       | % change |
|----------|------------|------------|----------|
| Total    | 16,986,335 | 20,851,830 | 22.8%    |
| Hispanic | 4,339,877  | 6,669,666  | 53.7%    |

- Dallas-Fort Worth and Houston-Galveston-Brazoria were the fastest growing metro areas in the country from 1990 to 1999. The population increased in the Dallas metro area 21.6% and in the Houston metro area 20.4%. Employment growth in these two areas also led the nation. The average annual growth rate increased in the Dallas metro area 3.83% and in the Houston metro area 3.06%.

- Collin and Denton counties saw the largest population growth

|        | 1990    | 1998    | Total Change | Hispanic Change |
|--------|---------|---------|--------------|-----------------|
| Collin | 264,036 | 428,803 | 62.4%        | 108.9%          |
| Denton | 273,525 | 384,020 | 40.4%        | 83.5%           |

- The percentage of the Foundation School Program paid by the state has decreased 6% from 2000-2003. This has caused a dramatic increase in local tax rates and collections.
- The national average state tax increase was 66% and local tax increase was 56% from 1990 to 1999. In Texas, state and local taxes both grew 74% from 1990 to 1999.
- From 1990 to 2000 the U.S. saw SAT scores rise an average of 14 points in math and 7 points verbal. In Texas, scores rose an average of 8 points in math and 7 points in verbal.

## **Financing the Public Schools of Texas: Some Issues of Growth, Equity, and Efficiency**

Dr. Ray Perryman, of The Perryman Group, was invited to testify before the Joint Select Committee on Public School Finance on February 7, 2002. Dr. Perryman testified on possible tax revenue for financing Texas public schools. Below is a brief summary of his testimony.

School districts, both wealthy and poor, are facing resource constraints and difficulties in maintaining programs in our public schools. Educators and tax payers have called for the following:

- Recapture be reduced or eliminated
- Overall property tax relief be granted
- More state funds be made available to pay for public education

The quest for a more suitable approach to school finance affords an opportunity to thoughtfully examine the overall framework of our tax system and make a significant step toward a more balanced fiscal system. The purpose of Dr. Perryman's study is to analyze key characteristics of several potential sources of revenue for school finance. Possible revenue sources include:

### **Property tax (as a base)**

- Property tax ranks last in growth potential and equity compared to other fiscal sources.
- Property values will continue to expand, but at a pace well below that of overall business activity.
- Property values are subject to less predictability and more prolonged cycles than the economy as a whole.
- The rate of property valuation appreciation varies across the state, adding uncertainty and complexity to the funding process
- Increased property values typically bear little relation to financial liquidity (ability to pay)

### **Sales tax**

- The State's sales tax is currently 6.25%, with most local governments raising the levy to 8.25%, one of the highest rates in the country.
- The sales tax has many exemptions that if eliminated would generate sufficient revenue to replace the property tax entirely.
- The sales tax base is projected to grow well in excess of property values and generally in line with other economic aggregates.
- The sales tax claims more resources and is more equitable than the property tax.

### **Business activity (value added) tax**

- It taxes the difference between revenue and the cost of purchased items.
- It is similar in principle to the current business tax in Michigan which is highly regarded for its fairness.
- It is very straightforward to administer compared to the franchise tax.
- The base is expected to grow in line with the general economy and slightly faster than many other non-property tax sources.
- The tax does not substantially alter economic decision-making because companies will generally maximize the value-added aspect to boost profits to make up for the added tax.

### **Franchise tax**

- It can be avoided by changing organizational structure.
- The base of the tax is projected to exceed overall economic growth and to expand in line with future revenue needs.
- The levy on capital is not specifically related to ability to pay in a given period.
- Its provisions related to capital cause the tax to be less equitable than some other sources, but much more balanced than the property tax.

### **Gross receipts (transactions) tax**

- This tax is levied on the total revenue of a firm.
- It is relatively easy to administer.
- If implemented, it would create intense political pressure to exempt certain categories of goods and services.
- The tax has previously been examined in Texas (TIF essentially tax on single industry).
- The growth in its base generally tracks the overall economy.

### **Income tax**

- This analysis provides a rationale to avoid a state income tax.
- The base of the tax grows generally in line with overall business expansion.
- The administration is relatively simple ; particularly if tied to the federal levy.
- The lack of a personal income tax in Texas is often cited as an advantage in economic development.
- Levying an income tax removes more private resources from productive use than any other major potential source.
- It is reasonable to assume that workers will seek additional compensation to offset the tax, a pattern observed in other states.

## **Funding Public Education Alternative Revenue Sources**

Mr. Dick Lavine, from the Center for Public Policy Priorities, was invited to testify before the Joint Select Committee on Public School Finance on February 7, 2002. Mr. Lavine testified on alternative revenue sources to fund public education. Below is a brief summary of his testimony.

### **Sales tax**

- Taxable sales are dropping as a percentage of total sales. Sales tax captures less of services than of retail trade. Services have grown 60 percent faster than retail trade over the last ten years.
- The state does not generate revenue from exclusions from the sales tax such as construction labor, personal services, business and professional services.

## Property tax

- The taxable value of property is stable as a percent of total value.
- Most of the cost of exemptions to the school property tax cannot be estimated because of insufficient appraisal data.
- To improve the accuracy of property tax valuations, the state should implement:
  1. Sales price disclosure
  2. Mandatory rendition of property
  3. Homestead, over-65 application supplied at closing

## Income tax

- A state income tax would slash school property taxes by 85 percent.
- The federal deductibility of a state income tax would ease the burden on Texas taxpayers.
- A state income tax with property tax reductions would benefit most Texans.

## Texas Taxes

Mr. James LeBas, from the Office of the State Comptroller, was invited to testify before the Joint Select Committee on Public School Finance on April 3, 2002. Mr. LeBas presented the Committee an overview of Texas' state and local tax system. Below is a brief summary of his testimony.

Breakdown of State and Local Taxes in Billions:

\$22.5 Local property tax

\$14.7 State sales tax

\$12.6 Other state tax

\$4.0 Local sales tax

In 1990 and 1999, Texas ranking with other states for collection of state taxes:

|                            | <u>1990</u> | <u>1999</u> |
|----------------------------|-------------|-------------|
| Per capita                 | 48          | 48          |
| Percent of personal income | 47          | 47          |
| Percent of GSP             | 49          | 48          |

In 1990 and 1999, Texas ranking with other states for collection of state and local taxes:

|                            | <u>1990</u> | <u>1999</u> |
|----------------------------|-------------|-------------|
| Per capita                 | 35          | 39          |
| Percent of personal income | 38          | 46          |
| Percent of GSP             | 47          | 46          |

From 1990 to 1999, state and local taxes have grown 74% compared to the 66% state and 56% local 50 state average.

Breakdown of Texas Property Taxes:

59% School levy (\$13.4 B)  
16% City levy (\$3.5 B)  
14% County levy (\$3.2 B)  
11% Special district levy (\$2.4 B)

FY 2001 Major School District Property Values (in billions):

|                           |         |
|---------------------------|---------|
| Single-family residential | \$443.4 |
| Commercial Real           | \$152.0 |
| Acreage (Land only)       | \$96.7  |
| Commercial Personal       | \$79.4  |

FY 2001 Three Main Texas State Taxes (in millions):

| Tax                          | Revenue  | % of total |
|------------------------------|----------|------------|
| Sales Tax                    | \$14,633 | 54%        |
| Motor vehicle sales & rental | \$2,906  | 11%        |
| Motor fuels                  | \$2,766  | 10%        |

FY 2001 Three Principal Exemptions, Exclusions, and Deductions (in billions):

|                                |              |
|--------------------------------|--------------|
| Sales Tax Exemptions           | 67% (\$18.2) |
| Sales Tax Exclusions           | 15% (\$4.1)  |
| School Property Tax Exemptions | 12% (\$3.3)  |

FY 2001 Value\* of the Five Largest Sales Tax Exemptions (in millions):

|                                 |          |
|---------------------------------|----------|
| Materials used in Manufacturing | \$7535.7 |
| Insurance Premiums              | \$2589.8 |
| Motor Vehicles                  | \$2417.1 |
| Food for Home Consumption       | \$1142.0 |
| Motor Fuels                     | \$1125.1 |

FY 2001 Value\* of the Five Largest Sales Tax Exclusions (in millions):

|                                        |         |
|----------------------------------------|---------|
| Physicians Services                    | \$547.9 |
| Legal Services                         | \$346.1 |
| Other Health Care                      | \$293.6 |
| New Residential Construction Labor     | \$252.5 |
| Architectural and Engineering Services | \$245.5 |

FY 2001 Value\* of the Five Largest Property Tax Exemptions (in millions):

|                                                  |          |
|--------------------------------------------------|----------|
| Productivity Value Loss                          | \$1161.7 |
| Homestead-State Mandated \$15,000                | \$944.2  |
| Homestead-Optional Percentage                    | \$306.2  |
| Homestead-65 and Over Freeze                     | \$288.9  |
| Homestead-State Mandated 65 and Over or Disabled | \$159.3  |

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\* The LBB has used the term "value" to define the potential cost to the state of these exemptions.

FY 2001 Value\* of the Three Largest Franchise Tax Exemptions (in millions):  
IRS Sec. 501 (c) (3) \$243.2  
Mutual Funds \$204.6  
Insurance Companies \$139.0

One loophole in state law allows companies that are limited partnerships to avoid paying franchise taxes. In the past two years, more corporations are becoming limited partnerships to avoid paying the tax. Using the "Delaware sub" strategy, a Texas company becomes a subsidiary of an out-of-state company based in a low-tax state, such as Delaware, to avoid the franchise tax.

## **Keeping Up With School Costs Is It a Tax Base Question?**

Mr. John Kennedy, from the Texas Taxpayers and Research Association, was invited to testify before the Joint Select Committee on Public School Finance on May 9, 2002. Mr. Kennedy testified on the use of tax revenue to fund Texas public schools. Below is a brief summary of his testimony.

- There is no tax base that will automatically produce sufficient revenue to keep up with the combined effects of enrollment growth and inflation. All the major tax bases work reasonably well during times of sustained economic growth, but all struggle to keep up with spending demands during economic downturns. Growth in revenues from the current state tax system more than keeps up with the underlying growth in school spending caused by enrollment growth and inflation.
- The mismatch between revenue sources and school spending results largely from conscious policy decisions by the Legislature to make program expansions (salary increases, health insurance). Policy choices (increase of homestead exemption, 10% cap on annual increases in homestead taxable value) have been made that reduce the ability of the local property tax base to carry the local load.

### **Income Tax**

- Two thirds of the revenue from an income tax must be used for property tax rate reduction. The remaining revenue must be used for education.
- The School district property tax cap would be reduced to reflect income tax revenue. Districts at the cap would stay at the cap, unless local voters approved raising the cap.
- The State's share of school funding would go up, the individual share of school cost would go up, and the business share of costs would go down (business property makes up the majority of property tax base).

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\* The LBB has used the term "value" to define the potential cost to the state of these exemptions.



## Chapter Five

### **Proposals for Substantial System Changes**

This chapter contains five proposals that call for substantial change to the school finance system. These proposals were submitted by Lieutenant Governor Bill Ratliff, Senator Florence Shapiro, David Thompson, Craig Foster and Lynn Moak and Dan Casey.

Each proposal represents the opinions of the committee member or individual offering the plan, and not necessarily the views of the committee as a whole. Cost estimates were prepared by the Legislative Budget Board unless otherwise noted.

## **Lt. Governor Ratliff's School Finance Proposal**

Lt. Governor Ratliff's plan would replace the current method of state funding that requires school districts to share local property tax revenue to meet a constitutionally mandated standard of equity that has been upheld by Texas courts. The plan calls for a voter-approved constitutional amendment to abolish local school property taxes for maintenance and operations, establish a statewide property tax to pay for Texas' public schools, and allow for a local enrichment property tax. Revenue raised by the new system would be combined with the state's existing school funding resources to form a new foundation for public school finance.

### **Voter-approved constitutional amendment to:**

- Abolish the current local school district authority to levy a property tax for the maintenance and operation of public schools leaving the current authority for debt service in place.
- Authorize the Legislature to levy a statewide property tax for the sole purpose of funding public schools in Texas.
- Grant the Legislature the statutory authority to allow school districts to levy a local property tax for educational enrichment, not to exceed \$0.10 per \$100 valuation.

### **Enact new school funding methodology by statute with the following features:**

**Statewide Property Tax:** Levy a statewide property tax of \$1.40 per \$100 valuation to combine with the general revenue appropriation to form the foundation school program funding.

- **Tier One--Basic Allotment:** Distribute the equivalent of \$30 per penny of the \$1.40 levied per weighted student to school districts to cover their base maintenance and operations budgets. When transportation and other adjustments are made, this would allow the distribution of about \$4,275 per weighted ADA (\$6,085 per student) which is, on average, about \$115 more per weighted ADA for maintenance and operations than is currently available to poorer school districts.
- **Tier Two--Local Enrichment:** Allow school districts through a local option election to levy a local enrichment property tax up to \$0.10 per \$100 valuation. School districts with tax bases less than \$300,000 per weighted ADA would receive a state guaranteed yield of \$30 per weighted ADA per penny of tax effort.
- **Tier Three--Debt Service Allotment:** The state will guarantee a yield of \$35 per penny of tax effort per ADA for all debt service on educational facilities, up to 30 cents.
- **Teacher Health Plan:** The Legislature should consider levying an additional statewide property tax on top of the \$1.40 in Tier One to fully fund a state paid teachers' health insurance plan equivalent to the plan available to state employees.

The LBB has determined this plan is revenue neutral.

## Senator Shapiro’s Proposal

Texas school finance reforms have been driven by Edgewood and a number of lawsuits that focused on equity within the public school system. The level of funding provided by the Legislature must have some relationship to the costs associated with achieving certain levels of student performance. Texas should conduct a comprehensive study using national experts and the four currently existing models to help “cost out” the price of a basic education. This proposal asks the Joint Select Committee to recommend a commissioned study by an outside party to define a basic education.

- **The Successful Schools Model**  
Created by John Augenblick, this strategy identifies the cost structures of school districts that are successful in terms of student performance and looks to see how much was spent per pupil. The basic idea is that if a group of districts with a variety of pupil characteristics can succeed with \$X per pupil, then the other districts should also be able to do so.
- **The Professional Judgment Model**  
Created by James Guthrie and Richard Rothstein, this approach gathers school professionals together to discuss and reach consensus on what inputs are needed for an adequate education and cost out those inputs.
- **The Econometric Model**  
Created by William Duncombe and John Yinger, (similar in theory to the Dana Center’s CEI Study) this approach uses regression analysis of data gathered from all schools in a state to identify a per-pupil spending level based on student performance taking into account the socioeconomic factors associated with schools. The findings indicate what an adequate expenditure level would be for a district with the average sociodemographic and student characteristics of the state with the spending level varied by the level of student performance desired. This method would include calculations for special needs of students, economies of scale, input prices, and even efficiencies.
- **The New American Schools Model**  
Created by Allan Odden, this model advocates school costs being based on popular, off-the-shelf school improvement models. Odden has “costed out” the expenses involved in all seven of the designs supported by New American Schools, a private group based in Arlington, Virginia that promotes innovation in public schools, and calculated the investment needed to bring every school district in the country up to the same spending levels. The seven models start out with a basic staffing level of one principal and 20 teachers for a school of 500 students. The model then comes up with a price tag, not only for a single state, but to bring all schools across the country to this level. The plan also calls for more federal dollars in education.

No cost could be determined by the LBB for this plan.

## **Mr. David Thompson's Proposal**

Mr. David Thompson addressed the concern that many districts are now taxing at or near the \$1.50 cap by calling for seven strategic adjustments that would allow our system to grow over time, limit further shifts in support of public education from the state to the local property tax, and meet current and future legal requirements. He emphasized the lack of capacity as the principle current problem.

### **General Observations / Assumptions:**

- We should reduce the complexity in our system only in areas that no longer serve a useful purpose, while maintaining the complexity that legitimately recognizes the variations between districts and students.
- In addition to making adjustments immediately in the system, it may be useful to conduct a periodic study of the cost of meeting the state's accreditation/accountability requirements, to ensure a "general diffusion of knowledge" is provided in a system that also retains some meaningful local discretion.
- This might be the opportunity to comprehensively revise the system to reflect the legal issues discussed by the Supreme Court in Edgewood IV such as the level of funding that is necessary, the role of unequalized enrichment and the recapture of local property tax revenues.

### **Seven Strategic Adjustments:**

- Move to a one tier system--Because there is no longer a rational distinction between the two tiers, reduce complexity by moving to a one tier system. Thus, for all pennies of tax effort, the same definition of WADA would be used, the CEI would be applied similarly, and transportation would be included.
- Revise the recapture mechanism--Equate the equalized wealth level (EWL) and the guaranteed yield level (GYL) up to an effective tax rate of \$1.40 so that there is no difference between Chapter 42 and 41 districts up to that level of effort and there are no "gap" districts. At effective tax rates above \$1.40, raise the EWL as the Chapter 41 district approaches \$1.50, allowing it to retain more of its property tax revenues as it gets closer to \$1.50. This increase in the EWL could be applied only to the incremental effort over \$1.40 or to the district's total effective tax effort.

- Statutorily increase the guaranteed yield level--Increase the GYL over a five-year period for Chapter 42 districts in order to give districts stability over time so that they are able to plan effectively and to keep capacity in the system by pushing districts away from their legal tax cap. If the Legislature does not appropriate funds for the statutory increase in any given school year, the maximum EWL for that school year, regardless of a Chapter 41 district's effective tax effort, would drop to the wealth level per WADA that corresponds to whatever funding level for the GYL that has been appropriated.
- Make Existing Debt Allotment (EDA) roll-forward automatic--Create a true debt tier and cover all debt by making the roll-forward automatic.
- Revise the Cost of Education Index (CEI)--Adopt the salary and benefits model, recommended by the Dana Center; base the CEI on a rolling average of three to five years data; identify regional indices, in addition to or instead of indices for each individual district.
- Create a new hold harmless--Guarantee the prior year's state and local revenue per WADA, plus 3 to 5 percent to cover growth and education inflation if the district is taxing at \$1.50. This would include, and not be on top of, any increase in the GWL. If a district received an adjustment in any year because of any local option exemption, the amount of any such adjustment would not be guaranteed under this hold-harmless.

Please refer to Appendix A-5 for Mr. Thompson's complete proposal, including changes to the existing tax system.

The LBB has determined this proposal would have an annual cost of \$1.1 billion.

## Mr. Craig Foster's Proposal

Mr. Craig Foster's proposal is based on the belief that in between the school finance system Texas has today and the system Texas will eventually adopt, significant interim reforms are possible and can produce meaningful results for Texas children.

- Provide special state assistance (SSA) to a district that has reached its maximum M&O tax capacity. A district has reached that capacity when it is taxing at its maximum M&O rate and does not have a local option homestead exemption. The amount of SSA should take into consideration the number of years the district has been at maximum capacity, the relative amount of the district's funding disparities (see below), and concurrent increases in other funding elements.
- Make detachment and annexation (D&A) of non-residential property the only option, other than consolidation of districts or tax bases, for meeting the wealth limitations under Chapter 41, with one exception: For the few districts that are Chapter 41 by virtue of residential value alone, maintain current option 3 for that portion of their excess wealth that cannot be achieved by D&A.
- Make D&A reversible and fractional so that a Chapter 41 district's retained wealth can be adjusted annually to the exact amount of the district's limit. Prioritize properties for D&A so that the smallest locally owned properties would be D&A'd last, if at all.
- Give County Appraisal Districts (CADs) and the Comptroller's Property Tax Division the legal and financial resources they need to fulfill their obligations to the children of Texas. All taxpayers must contribute their fair share to the state's public school system, allowing only for differences in local tax rates. School districts must be protected from losses of state aid or excess recapture due to problems which are largely beyond the control of the school districts.
- Formally adopt the Edgewood equity standards as minimum standards, calculate the standards in accordance with Edgewood IV, and adjust funding during the settle-up process to ensure the standards are met.
- Adopt a strategy to exceed the current minimum standards of adequacy and equity in response to the Supreme Court's conclusion in Edgewood IV that ". . . Texas can and must do better." Use the model proposed by the Equity Center in its policy statement entitled, "Offering a Fair and Rational Strategy for Achieving Real Equity and Adequacy" (see Appendix A-1).
- Commission unbiased studies to determine weights and indexes that accurately reflect cost differences among students and school districts for programs, facilities, and transportation.

- Investigate the distribution of funds under recapture options "3+", "3&4", and 4, to ensure that current practices are both legal and ethical, and that they conform to legislative intent.
- Extend the Existing Debt Allotment indefinitely and base state assistance on actual current debt service, not prior I&S tax history.
- Reject proposals to define "adequate" funding as any amount less than the amount at a very high percentile of students nationally, adjusted for generally recognized cost differences.
- Close the loopholes in the state's current tax system as a first step toward providing increased state funds for public schools.

The LBB has determined this proposal would have an annual cost of \$272 million.

Mr. Foster has determined that this proposal would be revenue neutral.

## **The Moak/Casey Proposal**

Mr. Lynn Moak and Mr. Dan Casey analyzed the entire school finance system and suggested various alterations to the system to be implemented over a six to eight year period.

### **Recommendations:**

#### Restructure the Foundation School Program

- Establish a single tier guaranteed yield program with recapture.
- Guarantee all districts a revenue yield equal to the 95th percentile of wealth per WADA.
- Provide annual cost of living adjustment plus 1% for all districts, regardless of wealth.
- Equalized wealth level would be statutorily established at the 95th percentile.

#### Tax Rate and Property Value Adjustments

- Use local, current year values.
- Use actual tax rates.
- Fund a strong state monitoring/compliance effort for appraisal district administration.
- Significantly adjust funding for fast-growing districts if current-year values are used.

#### Modify calculation of per pupil entitlements, creating a “Programs Factors” adjustment

- Create entitlement for full-day Pre-K programs for all four-year-olds.
- Create high school weight (1.05) and eliminate career and technology and gifted and talented weights.
- Create first-year student weight for fast-growth districts.
- Replace compensatory education weight with an “at-risk” weight.
- Replace bilingual education weight with “limited-English proficient” weight.
- Simplify special education weights.
- State should assume costs for very high-cost students.
- Add an indirect cost factor based on a federal indirect cost-type calculation.



#### Create a “Community Factors” adjustment

- Convert transportation allocation to weighted adjustment.
- Create a single small/mid-size adjustment formula based on student density.
- Amend the CEI using a modified Essentials Index (Dana Center) and multiply the value by 0.6 rather than 0.71.

#### Modify certain current categorical programs

- Eliminate compensatory education set-asides and replace with state funding for assessment costs.
- Eliminate 9th grade, early-elementary education and technology adjustments.
- Eliminate current hold-harmless provisions for the homestead exemption, teacher salaries, and health insurance.
- Expand the textbook program to incorporate high-cost instructional technology systems.

#### Teacher Health Insurance

- Separate funding of health insurance.
- Retain the current \$1000 health insurance/compensation allotment.
- Increase state funding for basic insurance plan in excess of required local contribution.
- Provide specific insurance allotment to replace the current formula funding of the insurance contribution.

#### Facilities

- Create funding assumptions for facilities based on the expected funding needs of \$3 billion in capital funds per year.
- Support a Constitutional amendment to validate a modified funding system.
- Increase TEA review.
- Provide automatic EDA-type funding.
- Expand IFA program to include equipment and approved administrative facilities.

The LBB has determined this proposal would have an annual cost of \$6.4 billion.

## Chapter Six

### LBB Analysis of Proposed Plans

The following is an analysis of plans and proposals submitted to the Committee. The following has been prepared by the Legislative Budget Board. All state cost implications are single-year estimates and are subject to change based on updates in the school finance system.

#### MULTI-COMPONENT PLANS

| Plan #1         |                                                                                       | Ratliff Statewide Property Tax                                                                                        |                                                                                                                                                                                    |                                                                                                                                                                             |                                                            |
|-----------------|---------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------|
| <b>Outcomes</b> |                                                                                       | <ul style="list-style-type: none"> <li>▪ Simplify the school finance system</li> <li>▪ Eliminate recapture</li> </ul> |                                                                                                                                                                                    |                                                                                                                                                                             |                                                            |
| Components      |                                                                                       | State Cost (Savings) per Year                                                                                         | Effect on Districts                                                                                                                                                                | Effect on Taxes                                                                                                                                                             | Implementation                                             |
| (a)             | Constitutionally abolish local property taxes for maintenance and operations          | Revenue-neutral                                                                                                       | Relieves districts of the responsibility of setting local M&O tax rates; certain districts would not maintain current revenue levels unless a hold harmless provision were enacted | Tax rates shift for most districts; some experience a tax rate reduction and others an increase depending on their current law relationship to the proposed \$1.40 tax rate | Requires a constitutional amendment and statutory revision |
| (b)             | Authorize a statewide \$1.40 property tax for the purpose of funding public education |                                                                                                                       |                                                                                                                                                                                    |                                                                                                                                                                             |                                                            |
| (c)             | Allow local school districts to levy an enrichment tax of up to \$0.10                |                                                                                                                       |                                                                                                                                                                                    |                                                                                                                                                                             |                                                            |

| Plan #2         |                                                                                                  | Thompson Single-Tier System                                                                                                                                   |                                                                                                      |                                                                                       |                                                                                                                                                                                                                         |
|-----------------|--------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Outcomes</b> |                                                                                                  | <ul style="list-style-type: none"> <li>▪ Simplify the school finance system</li> <li>▪ Reduce recapture</li> <li>▪ Increase local revenue capacity</li> </ul> |                                                                                                      |                                                                                       |                                                                                                                                                                                                                         |
| Components      |                                                                                                  | State Cost (Savings) per Year                                                                                                                                 | Effect on Districts                                                                                  | Effect on Taxes                                                                       | Implementation                                                                                                                                                                                                          |
| (a)             | Establish a guaranteed yield of \$30, using the "salary and benefits," rolling average CEI model | \$800 million cost                                                                                                                                            | All types of districts experience increased total revenue, with a statewide average of \$251 per ADA | Provides flexibility in the out years for districts to increase or maintain tax rates | Requires statutory revision: requires a complete revision of the calculation of district entitlements, since the current law delineation of weights in Tier 1 and the impact on WADA is moot under a single tier system |
| (b)             | Increase the recapture threshold concurrent with each penny of tax effort over \$1.40            | \$300 million cost                                                                                                                                            |                                                                                                      |                                                                                       | Requires statutory revision                                                                                                                                                                                             |
| (c)             | Allow districts at the \$1.50 tax rate cap to generate additional revenue                        |                                                                                                                                                               |                                                                                                      |                                                                                       | Requires statutory revision                                                                                                                                                                                             |

| Plan #3         |                                                                                                  | Foster Plan                                                                                                                                                                                               |                                                                                                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                                                                                                            |                                                                                                           |
|-----------------|--------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|
| <b>Outcomes</b> |                                                                                                  | <ul style="list-style-type: none"> <li>▪ Simplify recapture system by eliminating disparities based on commercial property</li> <li>▪ Increase state funding for districts at the tax rate cap</li> </ul> |                                                                                                                                                                                                                                                                                                                                                               |                                                                                                                                                                                                                                                                                            |                                                                                                           |
| Components      |                                                                                                  | State Cost (Savings) per Year                                                                                                                                                                             | Effect on Districts                                                                                                                                                                                                                                                                                                                                           | Effect on Taxes                                                                                                                                                                                                                                                                            | Implementation                                                                                            |
| (a)             | Detach non-residential property from Chapter 41 districts and annex it to Chapter 42 districts   | Revenue-neutral                                                                                                                                                                                           | Shifts revenue generating ability among districts, allowing current law property poor districts additional access to local revenue and limiting the ability of current law property-wealthy districts from earning local revenue above the recapture limit. Adoption of a different methodology would yield different results on a district-by-district basis | Impact would vary considerably among districts. May increase rates in property-wealthy districts with concentrations of commercial property, may lower taxes in property-poor districts. Adoption of a different methodology would yield different results on a district-by-district basis | Requires statutory revision                                                                               |
| (b)             | Provide supplemental assistance to districts at the \$1.50 tax rate cap                          | \$272 million cost                                                                                                                                                                                        | All types of districts would experience an increase in revenue and a significant number of students reside in districts experiencing the larger revenue increases. Increase revenue primarily for small rural districts and certain low and mid wealth districts; large suburban and high wealth districts benefit the least.                                 |                                                                                                                                                                                                                                                                                            | Requires statutory revision                                                                               |
| (c)             | Adjust the annual settle-up process to ensure funding levels at the 85th percentile of students. | Depends on the annual differential                                                                                                                                                                        | Could provide additional state aid to districts                                                                                                                                                                                                                                                                                                               | No impact                                                                                                                                                                                                                                                                                  | Would increase uncertainty in funding formulas and in state appropriations<br>Requires statutory revision |

| Plan #4         |                                                                                                | Moak Plan                                                                                                                |                                                    |                                                                                      |                                         |
|-----------------|------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------|--------------------------------------------------------------------------------------|-----------------------------------------|
| <b>Outcomes</b> |                                                                                                | <ul style="list-style-type: none"> <li>▪ Increase state funding for all districts</li> <li>▪ Reduce recapture</li> </ul> |                                                    |                                                                                      |                                         |
| Components      |                                                                                                | State Cost (Savings) per Year                                                                                            | Effect on Districts                                | Effect on Taxes                                                                      | Implementation                          |
| (a)             | Increase guaranteed yield to \$35.10                                                           | \$6.4 billion cost for all elements                                                                                      | Increased total revenue for all types of districts | Due to the significant increase in state aid, districts may opt to reduce tax effort | Requires significant statutory revision |
| (b)             | Increase equalized wealth level to \$351,000                                                   |                                                                                                                          |                                                    |                                                                                      |                                         |
| (c)             | Include pre-Kindergarten ADA in calculation of state aid                                       |                                                                                                                          |                                                    |                                                                                      |                                         |
| (d)             | Modify population funding weights, create a new "community factors" weight, and modify the CEI |                                                                                                                          |                                                    |                                                                                      |                                         |

## POLICY-SPECIFIC PROPOSALS

| Proposal #1                                                                              | Tax Rate Compression                                                                                                                                                          |                                                                                     |                    |                                                           |  |
|------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|--------------------|-----------------------------------------------------------|--|
| <b>Outcomes</b>                                                                          | <ul style="list-style-type: none"> <li>▪ Increase state funding</li> <li>▪ Provide local property tax relief</li> <li>▪ Increase local tax effort/revenue capacity</li> </ul> |                                                                                     |                    |                                                           |  |
| Strategy                                                                                 | State Cost (Savings) per Year                                                                                                                                                 | Effect on Districts                                                                 | Effect on Taxes    | Implementation                                            |  |
| Compress tax rates by \$0.05 on average statewide while maintaining total revenue levels | \$500 million cost                                                                                                                                                            | School districts maintain current law levels of revenue, but have reduced tax rates | Tax rate reduction | Could be implemented in 2004, but is a one-time mechanism |  |

| Proposal #2                                                                                     | Update/Modify the Cost of Education Index (CEI)                                                                                |                                                                                                                                                                                                                               |                 |                                                                                                                                                                                                                   |  |
|-------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
| <b>Outcomes</b>                                                                                 | <ul style="list-style-type: none"> <li>▪ Increase state funding</li> <li>▪ System improvement based on updated data</li> </ul> |                                                                                                                                                                                                                               |                 |                                                                                                                                                                                                                   |  |
| Possible Strategies                                                                             | State Cost (Savings) per Year                                                                                                  | Effect on Districts                                                                                                                                                                                                           | Effect on Taxes | Implementation                                                                                                                                                                                                    |  |
| Update the data used but maintain the current index methodology                                 | \$445 million cost (based on application of 71% in Tier I and 50% in Tier II)                                                  | Use of updated input factors changes the calculation of district entitlements; a hold harmless provision would ensure no districts lose state aid                                                                             | No impact       | <p>A new CEI could be implemented in 2004</p> <p>Texas is one of few states with a factor in their school finance formulae to address uncontrollable costs; some states automatically update the cost factors</p> |  |
| Adjust the index to reflect variables on the salary and benefits teachers are willing to accept | \$520 million cost (based on application of 71% in Tier I and 50% in Tier II)                                                  | Changing the basic methodology used for the CEI impacts district entitlements; a hold harmless provision would ensure no districts lose state aid                                                                             | No impact       |                                                                                                                                                                                                                   |  |
| Adjust index to use a three-year average on the salary and benefits model                       | \$625 million cost (based on application of 71% in Tier I and 50% in Tier II)                                                  | Of the three options presented here, this index provides the greatest increase in entitlements. Since the methodology change is significant, a hold harmless provision may be necessary to ensure no districts lose state aid | No impact       |                                                                                                                                                                                                                   |  |

| <b>Proposal #3</b>                                              |                                                                                                                                                                                                              | <b>Eliminate Recapture or Revise Recapture Provisions</b>                                                                                                                                                                                                                     |                                                                                                |                                                                                                                                |  |
|-----------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--|
| <b>Outcomes</b>                                                 | <ul style="list-style-type: none"> <li>▪ System simplification</li> <li>▪ Increase state funding</li> <li>▪ Provide relief to Chapter 41 districts</li> <li>▪ Close gap in access to debt funding</li> </ul> |                                                                                                                                                                                                                                                                               |                                                                                                |                                                                                                                                |  |
| <b>Possible Strategies</b>                                      | <b>State Cost (Savings) per Year</b>                                                                                                                                                                         | <b>Effect on Districts</b>                                                                                                                                                                                                                                                    | <b>Effect on Taxes</b>                                                                         | <b>Implementation</b>                                                                                                          |  |
| Eliminate recapture                                             | \$850 million cost<br><br>State cost of eliminating recapture while maintaining the equity of the Foundation School Program would be significantly higher                                                    | Increases revenue to the 126 property-wealthy districts<br><br>A negative impact on Chapter 41-partner districts and other Chapter 41-related programs (e.g., education service centers, technology consortia, JJAEPs)<br><br>Reduces overall equity of school finance system | Chapter 41 districts could use retained revenue to improve programs and/or reduce taxes        | Implementation could be phased-in over time<br><br>States have taken a variety of approaches to wealth equalization and equity |  |
| Increase the equalized wealth level from \$305,000 to \$315,000 | \$60 million cost                                                                                                                                                                                            | Chapter 41 districts retain revenue ranging from \$100 to \$150 per WADA, which could be used to improve programs                                                                                                                                                             | Chapter 41 districts could use retained revenue to reduce taxes and resulting taxpayer burden  | This has a negative impact on equity unless Tier 2 guaranteed yield is increased accordingly                                   |  |
| Apply recapture to I&S debt service                             | (\$80 million) savings from increased recapture                                                                                                                                                              | An increase in recapture for 67 Chapter 41 districts with I&S debt service                                                                                                                                                                                                    | Increase in recapture would put upward pressure on taxes and taxpayers in Chapter 41 districts | Reverses a change in law made in 1997                                                                                          |  |

| <b>Proposal #4</b>                          |                                                                                                             | <b>Improve Facilities Funding</b>                                  |                                                                                       |                                                                                        |  |
|---------------------------------------------|-------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------|---------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|--|
| <b>Outcomes</b>                             | <ul style="list-style-type: none"> <li>▪ System simplification</li> <li>▪ Increase state funding</li> </ul> |                                                                    |                                                                                       |                                                                                        |  |
| <b>Strategy</b>                             | <b>State Cost (Savings) per Year</b>                                                                        | <b>Effect on Districts</b>                                         | <b>Effect on Taxes</b>                                                                | <b>Implementation</b>                                                                  |  |
| Phase-out IFA and recognize all debt in EDA | \$84 million cost (based on \$3 billion in new debt each biennium)                                          | Results in a simpler system with more predictability for districts | Additional state assistance reduces local I&S taxes and resulting burden on taxpayers | A new combined program could start in 2004 with a phase-out of existing IFA guarantees |  |

| <b>Proposal #5 Change/Expand the Compensatory Education Proxy</b> |                                                                                                       |                                                                                        |                        |                             |
|-------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|------------------------|-----------------------------|
| <b>Outcomes</b>                                                   | <ul style="list-style-type: none"> <li>Align funding stream with target student population</li> </ul> |                                                                                        |                        |                             |
| <b>Possible Strategies</b>                                        | <b>State Cost (Savings) per Year</b>                                                                  | <b>Effect on Districts</b>                                                             | <b>Effect on Taxes</b> | <b>Implementation</b>       |
| Use "at-risk" student definition                                  | Likely savings to the state                                                                           | Loss of state aid                                                                      | No impact              | Requires statutory revision |
| Use Food Stamp Eligibility                                        |                                                                                                       |                                                                                        |                        |                             |
| Use CHIP Eligibility                                              |                                                                                                       |                                                                                        |                        |                             |
| Use Medicaid Eligibility                                          |                                                                                                       |                                                                                        |                        |                             |
| Add all of the above to the statutory eligibility definition      | Likely cost to the state                                                                              | Would likely tend to increase the number of students identified for the funding weight | No impact              | Requires statutory revision |

| <b>Proposal #6 Eliminate Hold Harmless Provisions</b>                      |                                                                                                         |                                    |                        |                                                                               |
|----------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|------------------------------------|------------------------|-------------------------------------------------------------------------------|
| <b>Outcomes</b>                                                            | <ul style="list-style-type: none"> <li>System simplification</li> <li>Decrease state funding</li> </ul> |                                    |                        |                                                                               |
| <b>Possible Strategies</b>                                                 | <b>State Cost (Savings) per Year</b>                                                                    | <b>Effect on Districts</b>         | <b>Effect on Taxes</b> | <b>Implementation</b>                                                         |
| Eliminate 1997 hold harmless associated with increased homestead exemption | (\$46 million) savings                                                                                  | Reduces state aid to 272 districts | No impact              | Requires statutory change<br><br>Could be phased-in or eliminates all at once |
| Eliminate 1999 hold harmless associated with professional salary increase  | (\$20 million) savings                                                                                  | Reduces state aid to 264 districts | No impact              | Could be eliminated in 2004, or phased-in in 2005                             |
| Eliminate 2001 hold harmless associated with group insurance provisions    | (\$15 million) savings                                                                                  | Reduces state aid to 25 districts  | No impact              | Could be eliminated in 2004, or phased-in in 2005                             |

| <b>Proposal #7 Eliminate Distribution of the Available School Fund to Chapter 41 Districts</b> |                                                                                                                                                               |                                                                                                    |                                                                                   |                                     |
|------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|-------------------------------------|
| <b>Outcomes</b>                                                                                | <ul style="list-style-type: none"> <li>Reduce unequalized revenue in the school finance system</li> <li>Decrease state funding</li> </ul>                     |                                                                                                    |                                                                                   |                                     |
| <b>Strategy</b>                                                                                | <b>State Cost (Savings) per Year</b>                                                                                                                          | <b>Effect on Districts</b>                                                                         | <b>Effect on Taxes</b>                                                            | <b>Implementation</b>               |
| Eliminate distribution of ASF to Chapter 41 districts                                          | Savings to the state; would increase the amount available for distribution to Chapter 42 districts thereby reducing the draw on other general revenue sources | Would decrease funding to Chapter 41 districts<br><br>Would have no impact on Chapter 42 districts | Could increase tax effort by Chapter 41 districts in order to regain lost revenue | Requires a constitutional amendment |

| <b>Proposal #8 Reduce Reliance on "Rooftop" Taxes</b> |                                                                                                                 |                            |                                                                                        |                       |
|-------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------|----------------------------|----------------------------------------------------------------------------------------|-----------------------|
| <b>Outcomes</b>                                       | <ul style="list-style-type: none"> <li>Shift the impact of local property taxes away from homeowners</li> </ul> |                            |                                                                                        |                       |
| <b>Strategy</b>                                       | <b>State Cost (Savings) per Year</b>                                                                            | <b>Effect on Districts</b> | <b>Effect on Taxes</b>                                                                 | <b>Implementation</b> |
|                                                       |                                                                                                                 |                            | Homeowners would experience reduced taxes; other payers would have an increased burden |                       |

## Chapter Seven

### **Breakdown of Proposed Changes and Expenditures**

In an era when property values and enrollment growth are rising and state sales tax revenues are falling, Texas finds itself in a unique position of attempting to increase the state's share of the public education financial burden while also meeting expanding costs in many other arenas, such as health care.

Since 1998 the state's projected increase in property values has constantly lagged behind actual growth, even after revised estimates have been used in the final budget process. The growth has been as phenomenal as it has been unprecedented, and while it has economic advantages, it has also made the process of writing a budget, which accurately reflects the state's fair share of financing public education, nearly impossible. This situation underscores the reasoning behind the creation of the Joint Select Committee.

The actual costs of education in Texas have been more predictable. Enrollment increases of about 2% per year have remained constant since the early 1990's. The tax cuts and school district employee health benefits have been a function of legislative action rather than the economy and the cost of teacher salaries were driven by both economic factors and legislative action.

There are, of course, many uncontrolled costs which have been studied in great detail by the Legislative Budget Board and the Dana Center. Those costs deserve consideration in the context of this charge; they produce annual education cost increases, but are constant components of increasing costs rather than driving forces.

This chapter examines proposals to change the current system by changing one or more of its component parts rather than changing the entire system. Three of the proposals in chapter five, which reviewed plans for complete overhauls of the school finance "chassis", had a similar component - moving to a single tier funding system. The concept underlying this change, is to simplify the current system by recognizing that using the current tier two as enrichment is no longer meaningful in light of inflation and increasing costs. The attempt to streamline the system would increase the state's share by eliminating the difference between the state's match for each penny of tax effort between tier one and tier two. Moving to this method of finance could accomplish the goal of a greater state share, but would not necessarily increase the ability of local districts to enrich their educational programs. To ensure an increase in the state share and even greater equity, a move to a single tier would have to be structured in such a way that no districts would lose state aid.

Another change to the current system would be to create an automatic cost of living adjustment in the formulas. Numerous possibilities for achieving this goal could be considered by the next Legislature, including those discussed by Mr. Moak, Mr. Thompson and Mr. Foster in their plans.

Changing the percentage of students in the state's equalized system is also a possibility. The 85<sup>th</sup> percentile was set in Edgewood IV as the constitutionally acceptable number of students within an equalized system, but as Committee members pointed out, raising the number of students in the equalized system would flow state aid to more districts. At what point the new percentage could be set and how much more state aid would be delivered by changing this component of the system, is again, a funding question for the next Legislature.

Using local, current year property values and actual tax rates to calculate state aid was another suggested change to the system. Some positive aspects of this concept include simplification of the system and an end to the current one year lag in state recognition of rapid changes in either property values or student population. This could, if implemented, increase or decrease state aid to districts in a manner that is in sync with actual changes at the local level. Several Committee members noted the possible drawbacks to this proposal as well. A move to current year values would create difficulty for school districts in the budgeting process. Both the timing of budget adoption and the uncertainty in funding formulas are major obstacles to implementing the use of current year values.

Program changes were also proposed, such as creating full day pre-kindergarten programs for all four year olds, adding more rigorous courses to the required curriculum and placing more emphasis on foreign languages and the arts. Such changes would, of course, have costs, and whether to increase funding or cut other programs to fund these would need to be addressed by the next Legislature.

Creating new weights and revising the current Cost of Education Index (CEI) were also considered. Committee members discussed updated, or more simplified weights, and adding an indirect cost calculation to current funding formulas. Detailed studies of changes in the CEI were done by both the Dana Center after the 1999 session and the Legislative Budget Board prior to the 1997 session. Detailed overviews of their studies are included in Chapter 4 and the appendix of this report.

Other suggested component changes to the current system involve the concept of more flexibility at the local level. A more flexible school year was proposed, with the argument that a cost savings could result if districts could tailor the length of their school year to the needs and achievement of their students rather than following a state mandated 180 day school year.

Greater flexibility in budgeting at the local level was also proposed, again with the reasoning that if districts were not mandated by the state to spend certain amounts of money on specific programs, then overall cost savings could be achieved. Savings could



only be considered worthwhile in instances where student achievement was maintained. More local budget flexibility, coupled with a strong and consistently more challenging accountability system could be a key factor in letting the current system of local control and accountability work to the state's economic advantage.

The charge required the Committee to consider transportation in its discussion of the cost of education. The Legislative Budget Board confirmed that the current funding mechanism had not been updated in over a decade. Committee members showed interest in proposals made by Mr. Lynn Moak and the Dana Center to increase the transportation funding formula. Those proposals are included in the appendix of this report.

Fully funding the current teacher health insurance program, including the \$1,000 allotment, was also considered by Committee members as required by the charge. No changes to the current system were proposed and the Committee supported maintaining the state's commitment to funding for the full biennium, as required by statute. The Legislative Budget Board has estimated the cost of continuing the current system with full funding to have a cost to the state of over \$1 billion.

Providing additional facilities funding and streamlining the current system, including automatic funding of the Existing Debt Allotment and expansion of Instructional Facilities Allotment to include equipment and administrative facilities, were also topics touched on by the Committee. Different plans for such changes had differing costs. Those costs estimates are provided by the Legislative Budget Board in Chapter Six.

Changing the statute to allow districts to set tax rates over \$1.50, essentially raising the current \$1.50 cap set by Section 45.003(d) of the Education Code, was also discussed. Committee member David Thompson pointed out that statute allows districts in counties over 700,000 in population as of the most recent census to go up to a combined M & O and I&S tax rate of \$2.00. Since adoption of that statute, districts in ten additional counties may have become eligible to increase above \$1.50. The cost to the state and the resulting benefit to local districts can not be accurately projected due to the number of variables involved. Variables include the cost of the state providing a guaranteed yield above \$1.50 (if it chose to do so) and the number of districts electing to go above the current \$1.50 cap. Further discussion of this change is provided in Chapter Eight, Revenue Proposals.

Proposals to allow the use of textbook funds to be used for technology in the classrooms were also discussed. Currently the \$30 technology allotment and the cost of textbooks are covered by the Available School Fund.

The charge also required the Committee to consider per capita spending in the state. Included in the appendix are annual statewide and local per capita expenditure charts, which show substantial increases in expenditures over the last 15 years, although not adjusted for inflation. This discussion led to a hearing in September 2002 on the subject of adequacy. The proposal by Senator Shapiro and the September hearing are covered in Chapters Five and Nine respectively. The Committee was also informed that the

Legislative Budget Board conducts interim studies on per pupil spending that could be expanded to explore additional questions related to per capita spending.

TEA data shows that since the 1992-93 school year state and local expenditures have risen from \$9.85 billion to \$26.39 billion in the 2002-03 school year. This averages out to an expenditure of \$3,053 per student in average daily attendance (ADA) in 1992-93, increasing to an average of \$6,796 per ADA in the 2002-03 school year. In other words, spending per student has more than doubled in ten years. Total state aid to districts in the 1992-93 school year was \$6.9 billion and has risen to \$10.9 billion for the 2002-03 school year. The average expenditure per ADA by the state in 1992-93 was \$2,140; the average state spending per ADA in 2002-03 was \$2,814. These figures illustrate that while state expenditures have risen dramatically, the level of state spending per pupil has not kept pace with local increases in expenditures over the last decade (see Appendix Exhibit B-19).

## Chapter Eight

### Revenue Proposals

Some of the suggested changes to the Texas system of public school finance are revenue-neutral, or would not require a significant infusion of revenue on the part of the state. However, some of the changes are very costly, and full implementation of the more far-reaching suggestions could necessitate billions in additional spending.

In addition to its comprehensive review of the state's school finance system as a whole, the Joint Committee on Public School Finance was also tasked with examining "the revenue resources for funding public schools, including a review of the state's tax system as it relates to public school finance." As a part of this effort, the Committee heard testimony about changes to the current state tax structure which could increase state revenue.

Most of these suggested proposals would increase the revenue available to the state General Revenue Fund (GR), and would likely require adjustments to the state formula for flowing GR funds through to individual districts. Some suggestions are modest reforms to existing taxes, primarily the elimination of certain exemptions or exclusions from one tax or another. Other changes seek to enhance collection of current taxes, and are not new taxes in and of themselves.

In 1997, the House of Representatives Select Committee on Revenue and Public Education Funding did an exhaustive study of state revenues. Most of that work is still applicable today. The Joint Select Committee did not attempt to conduct an in-depth review of state revenues because the work has already been done and is available today. The Joint Select Committee wishes to acknowledge the efforts of the House Select Committee on these important issues.

#### Franchise Tax Changes

The franchise tax is the fourth largest revenue source in the state, bringing in \$1.96 billion in state funds during the 2001 fiscal year alone. This represented seven percent of the total revenue for the state that year. The franchise tax is imposed on each corporation that does business in this state or that is chartered or authorized to do business in this state, and each limited liability company that does business in this state, that is organized under the laws of this state, or is authorized to do business in this state.

Other types of business structures, notably general and limited-liability partnerships and sole proprietorships, are not subject to the tax. Additionally, certain industries, such as corporations providing insurance, are wholly exempt, often because they are taxed under other statutes. A number of other industries, such as solar energy companies, credit

unions, and electric cooperatives, are also exempt. Generally speaking, the tax is not applied to non-profit enterprises.

The franchise tax was first adopted in 1907, and underwent few changes until the mid-1980s. It is considered to be a “privilege tax,” meaning that corporations are granted certain privileges by the state in exchange for paying the tax. Most notable of these privileges is the limitation on personal liability of corporate officers, directors and stakeholders for actions taken on behalf of the business. There are approximately 450,000 businesses in Texas that are subject to the tax.

The tax is basically levied against a corporation’s net worth or its earned surplus, which is essentially the portion of the company’s income plus executive compensation, apportioned to Texas. The tax rate is set at 0.25 percent of the net worth, and 4.5 percent for earned surplus, and the corporation essentially pays the higher of the two amounts.

The Committee heard testimony suggesting that the state should consider including other types of business structures under the franchise tax, primarily limited-liability partnerships (LLPs). Supporters of this position pointed out that many Texas companies are now organizing (and re-organizing) as LLPs to eliminate their franchise tax liability. In one typical scenario, small or closely-held Texas corporations convert to a limited partnership composed of a corporate general partner owning a 0.1% interest in the partnership, with Texas citizens being the limited partners who own the remaining 99.9%.

After restructuring, the franchise tax liability of the “general partner corporation” is expected to be reduced to zero, because its 0.1% interest in the partnership generally fails to generate total receipts in excess of the law’s \$150,000 minimum income threshold. The limited partners are not subject to the tax.

Larger or multi-state corporations may employ a similar strategy, except that the original corporation creates a corporate subsidiary as the general partner (typically in Delaware or another state that does not impose a franchise tax), as well as a second subsidiary corporation which serves as the limited partner. After this restructuring, the only income flowing to the original corporation comes in the form of dividends from its subsidiaries. These dividends are not Texas receipts because the subsidiaries are not Texas corporations, and without income from Texas receipts, the liability of the original corporation is zero.

Meanwhile, the “general partner” corporate subsidiary, while subject to the franchise tax, benefits from a dramatic reduction in tax liability because of its minute interest in the partnership. The “limited partner” corporate subsidiary is not subject to the tax because its only nexus in the state is an interest in a limited partnership. The State Comptroller estimates that tax planning schemes such as these will cost the state \$247 million in revenue during the 2002-2003 fiscal biennium.

There are a number of exemptions carved out of the franchise tax for certain types of businesses. These exemptions are largely provided to corporations which are taxed under some other mechanism (such as insurance companies), or as an incentive for certain types of enterprises (such as the manufacturing of solar energy devices). The total cost of these exemptions for FY 2001 is \$637.3 million.

In addition, the Tax Code provides for certain deductions from franchise tax obligations. The deduction will reduce a corporation's overall tax burden, and is generally granted as an inducement for businesses to engage in certain practices (such as investing in solar energy devices), or to be consistent with federal tax policies. Deductions from the franchise tax include: a small business exception for those firms with tax liability of less than \$100, or gross total receipts of less than \$150,000; deductions for food and health-care supplies; deduction of accumulated earned surplus business loss during the preceding five years, and; waiver of the requirement to add-back officer and director compensation for corporations with fewer than 35 shareholders. Added together, these deductions save corporations more than \$500 million in franchise taxes annually.

There are special accounting methods available to certain corporations which may further reduce their franchise tax obligations. These exceptions to standard practice may help reduce the compliance burden for small businesses, and encourage certain types of activities on the part of corporations. Generally, these special accounting methods deal with the way a company apportions its business activities in Texas. They may allow small companies to use simplified accounting rules, which may result in lower tax liability. These exceptions account for a reduction in state franchise tax revenues of approximately \$40 million annually.

Credits and refunds available to qualifying businesses further reduce franchise tax collections. These are designed to reward taxpayers for certain types of actions. Examples include credits for: construction of a day care center, employment of TDCJ inmates, research and development, capital investment, and before- and after-school care for children between the ages of five and thirteen. For FY 2002, these credits and refunds are estimated to account for a \$223 million reduction in state franchise tax receipts.

Overall, the Committee consistently heard from witnesses who argued that the current tax structure does not truly measure the economic activity in Texas. The concept that businesses seek to reduce their tax liability is nothing new; businesses in Texas and around the country spend a great deal of time, energy and money to lessen their state, federal, and local tax obligations through a variety of mechanisms. However, some observers suggested that this problem has become particularly acute in Texas, the result of sophisticated tax planning strategies coupled with an outdated tax structure.

"Tax fairness" was a frequently-discussed concept during the hearing process. State revenues are drawn disproportionately from corporations and industries that are property-intensive, or which sell products to the general public. These same corporations and industries also bear a disproportionate burden with regard to school property taxes. Meanwhile partnerships and industries that are predominantly service-based typically

have a much lighter tax burden across the board. The extent to which this is a problem is a question for the Legislature to resolve, as is the question of whether to eliminate those loopholes, exemptions and exclusions in the current law.

### Property Taxes

Overall, local property taxes account for 43% of the total state and local tax burden in Texas. There are four basic types of property taxes levied in Texas - School, City, County, and Special District (such as a hospital district or a port authority) that are estimated to generate \$22.5 billion in FY 2001. School taxes are by far the largest property tax levy of the four, making up 59 percent of the total revenue, or \$13.4 billion.

Revenues generated on a district-by-district basis equate to roughly 58 percent of the state and local public school spending in Texas. The lion's share of this amount - 95 percent - is generated through ad valorem taxation of residential and business property by locally elected school boards. The remainder is earned through miscellaneous extra-curricular activity fees, interest earnings, and tuition charges, all of which vary from district to district.

The residential portion of the property tax base is "real" property, which is the land and any improvements to the property. The business portion includes real property, as well as capital assets, inventories, and defined intangible goods, such as mortgages or stocks and bonds. Both types of property are subject to the same ad valorem tax rate, as set by the school district.

All residential and business property in Texas is subject to ad valorem taxes unless specifically exempt by the state constitution, or exempted by the Legislature under constitutional authority. Generally, intangible personal property, items such as annuities, pensions, and most stocks or bonds, is not taxable. Of course, property exempt from taxation under federal law is also exempt.

The Texas Tax Code requires businesses to declare, or "render" all personal property (such as furnishings, inventory, and equipment) that is used in the production of income each year. This property is subject to taxation by school district, cities, counties, and other entities with authority to levy property taxes. *However, state law provides no penalty for failure to render.* As a result, some have estimated that Texas businesses have failed to disclose or under-reported as much as \$36 billion in taxable personal property statewide.

Some witnesses testified before the Committee that enhancements should be made to current law to obligate businesses to report their taxable personal property. Proponents of this position endorsed civil and/or tax penalties for those businesses which improperly render, as well as audit authority for county appraisal districts (CADs). Others voiced concerns about granting too much authority to CADs, for fear of fostering an overly-adversarial relationship between taxpayer and appraiser.

## Mandatory Property Sales Price Disclosure

In Texas, County Appraisal Districts (CADs) use mass appraisals to calculate the value of most residential and commercial properties, primarily because there are simply too many properties for each to be reviewed individually. Under this approach, the CAD classifies properties using factors such as size, use, and construction type. Then the CAD utilizes information regarding recent property sales in the area to appraise the value of typical properties within each class. Finally, by factoring in age and location, the district uses the typical property values to appraise all value in the class.

There is no legal requirement for real estate sales prices to be filed with CADs, although this information is collected by Realtors. In some counties, this information is shared with CADs, but this is not the case statewide. Where this information is lacking, CADs rely more heavily on value estimates than on actual sale prices. The Committee heard testimony from appraisal officials that they often purposefully overvalue individual properties in order to spur owners to contest the appraisal and disclose sales price information to the CAD during the hearing process.

Some witnesses testified that mandatory disclosure of sales price information, particularly of residential properties, would allow CADs to more accurately establish values for tax purposes. They point out that many other states require such disclosure, and that the information is already being collected by Realtors. Opponents of this concept cited privacy issues as their primary concern. No estimates of the amount of property that is untaxed due to undervaluation of property were offered to the Committee.

## Sales Tax

Sales taxes make up the majority of state tax revenue, roughly sixty percent of total tax collections. The state portion of the sales tax is 6.25 percent, with municipal government, economic development entities, and mass transit agencies having the ability to add as much as two percent to the rate. There are broad categories of exemptions, but generally the tax is paid by businesses and consumers for a variety of goods and services purchased in Texas or imported for use in the state.

Exemptions from the sales tax are generally provided for basic necessities, such as groceries, medications, and residential utilities. Sometimes, goods that are normally taxable are excluded from taxation when purchased by religious, governmental, or not-for-profit entities. In other cases, tangible goods that might otherwise be taxed are exempted because they are taxed under a different statute - such as automobiles, motor fuels, and insurance premiums. By and large, services are not subject to the sales tax, unless specifically included by law. Among the untaxed services are those provided by doctors, lawyers, architects, and accountants.

While the state sales and use tax is the largest source of revenue for the state, generating roughly \$14 billion for the state in 2000, the value of the exemptions and exclusions is even larger. The State Comptroller estimates that application of the tax to those goods

and services that are currently untaxed would increase state revenue by nearly \$20 billion in 2002. A chart of the goods and services that are currently excluded or exempted from state sales taxes can be found in Appendix B, exhibit B-20.

### Professional Fees

There are approximately ninety categories of professional fees imposed by the state, covering a vast array of professions. Barbers, court reporters, doctors, elevator inspectors, land surveyors, notary publics, plumbers, salvage dealers, and telephone solicitors, as well as many others, all must pay professional fees to the state in order to conduct business in Texas. There are more than 1.6 million fee payers in the state, generating in excess of \$220 million in state funds.

The last fee increase imposed by the Legislature was in 1991, when a \$200 annual fee was enacted (primarily for accountants, architects, and medical professionals such as physicians and dentists.) Most professional categories were not subject to this increase, as their rates are set by rule through their administering regulatory agencies. Most of these fees are imposed annually, although some are biennial, or subject to multi-year renewals.



## Chapter Nine

### Adequacy

On September 13, 2002, the Joint Select Committee on Public School Finance met to discuss the issue of “adequacy” in funding public schools.

### Determining Finance Adequacy

Mr. Michael Griffith, of the Education Commission of the States, was invited to testify regarding education finance adequacy before the Joint Select Committee on Public School Finance on September 13, 2002. The following is a summary of his testimony.

Nationwide, adequacy studies have become a growing trend. The reasons for adequacy studies include compliance with court rulings, alignment of educational finance with accountability programs, and to reevaluate a state’s school finance system. Eleven states performed adequacy studies between 1993 and 2002. Four models have been created to determine finance adequacy.

The successful schools/districts model examines spending at schools that have been successful in meeting state proficiency standards, and sets the adequacy level at the weighted average of the expenditures of such districts. This method is being used in part by Ohio, Illinois and Mississippi.

The professional judgment model uses panels of education experts (teachers, administrators and local school finance personnel) to identify the resources needed to establish model schools capable of achieving state education goals. The resources are then priced out and totaled to determine the adequate fiscal base for a school; the base can be adjusted for differing characteristics of students and districts. This model has been used in Oregon, Maine and Wyoming and is under consideration in a number of other states.

The statistical model takes all factors into account. It examines all aspects of a school, uses the data collected to determine a statistically-based finding of what an average student needs to succeed.

In the whole-schools approach, school or district leaders select and set up a model they believe will work. They determine the cost of implementing the model in a school, including adjustments that would need to be made in the school.

Chairman Sadler pointed out that defining adequacy can be a double-edged sword, since outcomes can drive both higher state spending and legal challenges.

## **Kansas School Finance and Cost of a Suitable Education**

Mr. Dale Dennis was invited to testify before the Joint Select Committee on Public School Finance on September 13, 2002. Mr. Dennis is Deputy Commissioner of Education for the state of Kansas and testified on education finance adequacy. The following is a summary of his testimony.

The Kansas Legislature employed the firm of Augenblick & Meyers, Inc. to study the adequacy of public school funding. Under the Kansas state constitution “The legislature shall make suitable provision for finance of the educational interests of the state.” The primary purpose of the study was to determine the funding level necessary for school districts to meet the objectives of a “suitable” education. Augenblick & Meyers recommended that Kansas implement the following changes to their public school financing program:

Kansas should continue to use a foundation program in combination with a second tier (Local Option Budget) as the primary basis for distributing public school support. The foundation level (base cost) should be raised in the future to a level that would be equivalent to \$4,650 in 2000-01. The foundation level should be adjusted by a regional cost factor using figures from the National Center for Education Statistics until such time as the state conducts its own study. The foundation level should be adjusted in recognition of the higher costs associated with:

- Moderate size and small school districts;
- Special education programs;
- At-risk students (based on the number of students participating in the free lunch program)
- Bilingual education

The adjustments should be based on formulas that are sensitive to the enrollment level of school districts.

There should be no pupil weight specifically for vocational education. The cost of vocational education should be included in the base cost figure. The state should continue to use its density-based formula for transportation support but include the full cost of serving students living 1.25 miles from school as part of the analysis. The weight for students in newly opened schools should continue to be used although it should be used for three years, not two years, and the weight should decrease each year.

School districts should be expected to contribute to the foundation program based on a property tax rate of 25 mills on assessed valuation. The second tier (Local Option Budget) should permit districts to raise up to 25 percent more than the revenue generated by the foundation program (based on the foundation level and the adjustments for size,

special education, at-risk students, and bilingual students). The state should continue to equalize the second tier in the same manner as it does currently.

The foundation level should be restudied every 4-6 years or when there is either a significant change in state student performance expectations or a significant change in the way education services are provided. In intervening years, the foundation level should be increased based on the work of a committee designated by the Legislature to determine an annual rate of increase, which should consider annual changes in the consumer price index in Kansas.

## **Maryland Bridge to Excellence in Public Schools Act**

The following is a summary of recent finance reforms in Maryland.

Based on a framework established by the Commission on Education Finance, Equity, and Excellence (Thornton Commission), Senate Bill 856 restructures Maryland's public primary and secondary education financing system and phases in enhanced state aid for education over a period of six fiscal years. Additional fiscal 2003 state aid of \$74.7 million is financed through a 34-cent increase in the state tax on packs of cigarettes. Between fiscal 2004 and 2008, 27 existing state aid programs are eliminated and the funding that was provided through the programs is replaced with enhanced funding through programs that distribute state aid to local school systems based on student enrollments and local wealth. By fiscal 2008, the State will provide an additional \$1.3 billion in education funding to local school systems above what the State would have provided under the existing state aid structure.

The commission's final report included recommendations founded on a standards-based approach to school financing. In this approach, the role of the State is to: (1) set academic performance standards for students; (2) ensure that schools have sufficient resources to achieve the standards; and (3) hold schools and school systems accountable when they fail to meet standards. The standards-based approach to school finance includes two significant departures from Maryland's existing school finance structure. First, the approach demands that a link be established between the level of funding that school systems receive and the outcomes that are expected of students. Second, the approach gives local school systems broad flexibility to decide how to best utilize resources to meet the needs of their students.

The Thornton Commission attempted to establish a rational link between the amount of funding that is needed to ensure that schools and school systems can meet state performance standards and the amount of state funding that is provided to school systems. To accomplish this goal, the commission used results from "adequacy" studies conducted by a private consultant (Augenblick & Myers) for the commission. The studies estimated per pupil costs that would be needed to ensure that students with no special needs could meet state standards. In addition, the studies estimated the additional costs associated with adequately serving students in three special needs categories: special

education students, students with limited English proficiency, and economically disadvantaged students. SB 856 establishes funding formulas that are directly linked to the estimated costs of achieving state performance standards. This approach assumes that local school boards and superintendents are in the best position to make decisions about how to use education funding.

Funding for the legislation derives from an increase in the tobacco tax on a pack of cigarettes from 66 cents to \$1 beginning June 1, 2002. The increased tax rate is expected to yield approximately \$101.4 million in fiscal 2003. The first \$80.5 million it generates will be placed in a special fund that will be used to provide funding for education in fiscal 2003. Revenues generated after the first \$80.5 million will be placed in the State's general fund. After fiscal 2003, the increased tobacco tax rate is expected to generate approximately \$70 million annually, and all of the revenues will be placed in the general fund. Twenty-seven existing state education aid programs are eliminated or phased out, and the funding for the programs is replaced by enhanced funding for four programs -- one based on total student enrollment and three based on the enrollments of three categories of students with special needs.

Under the funding formulas established in the bill, greater proportions of state aid are targeted to school systems with low wealth and school systems with high numbers of students with special needs. The amount of state aid distributed through the formulas is linked to the per pupil amounts identified in the adequacy studies as the appropriate levels of funding needed to ensure that students with special needs can meet state performance standards. An overall state share of 50 percent for each program is phased in from fiscal 2004 to 2008. Local school systems receive a share of the funding for the programs based on local enrollments of special needs students and local wealth. Less wealthy jurisdictions receive a greater share of the per pupil funding, although, by fiscal 2008, no school system may receive less than a 40 percent state share of the per pupil amounts identified in the formulas. A higher per pupil amount to be shared by the state and local governments is phased in from fiscal 2004 to 2008. During the phase-in period, the full-time equivalent enrollment value for a kindergarten student is increased from 0.5 to 1.0. The overall state share of the Foundation Program is 50 percent. By fiscal 2008, the minimum state share of the per pupil foundation amount that a local school system may receive is 15 percent.

SB 856 creates the Guaranteed Tax Base Program, which will be phased in between fiscal 2005 and 2008. The program distributes state funding to local jurisdictions that: (1) have less than 80 percent of the statewide wealth per pupil; and (2) provide local education funding above the local share required under the Foundation Program. The amount provided to each local school system is equal to the additional funding that would have been provided by the local government if the same education tax effort was made and the jurisdiction had the wealth base that is "guaranteed." Regardless of local education tax effort, local school systems may not receive more per pupil than 20 percent of the base per pupil amount established in the Foundation Program.

SB 856 requires each local school system to develop a comprehensive master plan that describes the strategies that will be used to improve performance in every segment of the student population. Each plan must include goals that are aligned with state standards, implementation strategies, methods for measuring progress toward meeting goals, and time lines for the implementation of strategies. The bill also enhances state aid for base student transportation grants as well as grants for the transportation of disabled students. The base transportation grant is enhanced for 15 counties that experienced aggregate enrollment increases between 1980 and 1995, a time when the transportation formula did not include annual adjustments for enrollment increases.

The Thornton Commission did not evaluate the adequacy of the State's public school facilities because this fell outside the scope of the commission's charge. However, in its final report, the commission noted that adequate public school facilities are a necessary component of a good public school system. SB 856 established a Task Force to Study Public School Facilities.

## **History of Cost Studies in Texas**

Ms. Ursula Parks, from the Legislative Budget Board, and Mr. Joe Wisnoski, from the Texas Education Agency, were invited to testify before the Joint Select Committee on Public School Finance on September 13, 2002. They testified on the legislative history of school finance studies in Texas. Below is a brief summary of their testimony.

### **1984**

- HB 72 charged the State Board of Education (SBOE) with the Price Differential Index (PDI) study
- HB 72 also charged the SBOE with a study of average accountable costs to school districts in providing quality education programs that meet the accreditation standards prescribed by law

### **1987**

- SBOE was required to adopt rules for the PDI
- SBOE was charged with a study to find a minimum basic accountable cost per student to provide a quality education

### **1989**

- Cost of Education Index (CEI) replaced PDI, SBOE was charged to adopt rules regarding CEI
- SBOE charged with study of basic cost, exemplary cost, facilities and transportation

## **1990**

- Responsibilities for studies was moved to the Legislative Education Board (LEB) and the Legislative Budget Board (LBB)
- LEB was directed to adopt rules for the calculation of funding elements, including the basic allotment, formula weights, tax rates for local funding, etc.
- LEB and LBB were charged with biennial studies, which included fiscal neutrality of the system, levels of tax effort necessary for each tier, capital outlay and debt service requirements, etc.
- The Foundation School Fund Budget Committee (FSFBC) was charged with adopting rules for the calculation of the funding elements, including CEI and program cost differentials

## **1991**

- LEB again was charged with biennial study of determining the equalized funding elements to be provided to the FSFBC for their calculations

## **1993**

- LEB was abolished
- LBB was charged with biennial study of determining the equalized funding elements to be provided to the FSFBC for their calculations
- CEI was set to the index adopted by the FSFBC in December 1990

## **1995**

- LBB was charged with biennial study of determining the equalized funding elements
- CEI was set to the index adopted by the FSFBC in December 1990

## **1997**

- FSFBC was abolished
- LBB was charged with biennial study of determining the equalized funding elements
- CEI was set to the index adopted by the FSFBC rule as that rule existed in March 1997

## **1999**

- LBB was charged with biennial study of determining the equalized funding elements
- LBB was also charged with determination of the projected cost to the state of ensuring that each district be able to maintain existing programs without increasing property tax rates

## 2001

- LBB was charged with biennial study of determining the equalized funding elements
- LBB was also charged with determination of the projected cost to the state of ensuring that each district be able to maintain existing programs without increasing property tax rates

### **Dana Center Project Proposal Texas Adequacy Study**

The following is an overview provided to the committee by the Dana Center.

The Charles A. Dana Center at The University of Texas at Austin proposes to conduct a comparative adequacy study for Texas that consists of four major components, working with a team of leading economists, educators, and education policy researchers. Over a two-year period, the Dana Center and its partners propose to do the following:

1. Work with educators, policymakers, business leaders, and members of the public to specify three sets of outcomes that are measurable using Texas data, are aligned with federal requirements, and reflect the education goals of the state;
2. Conduct a benchmarking analysis of cost-effective schools and school districts, to derive cost-estimates that include analyses of efficiency;
3. Conduct the first comparative analysis of two recognized approaches for connecting the financing and performance of schools, to generate ranges of projected costs; and
4. Construct a computer model that allows users to explore the fiscal implications of using the research findings to revise Texas school finance formulas.

Each of these components is designed to produce major deliverables and are arguably fundable projects in their own right. Together, they would generate a comprehensive set of peer-reviewed policy recommendations and technical tools for revising the Texas school finance formulas for Maintenance and Operations. A short description of each component follows.

#### **Specifying multiple sets of outcomes**

In most states, adequacy studies have involved the application of one of four approaches (the successful schools approach, the professional judgment approach, the statistical approach, or the comprehensive school reform approach) to estimate the costs of producing certain levels of student achievement. In the Texas adequacy study, researchers would specify three sets of outcomes and apply two of the four recognized approaches—the successful schools approach and the statistical approach—to estimate ranges of costs associated with different outcomes.

- **Statutory requirements:** The first set of outcomes for which the team would generate cost estimates are those associated with current statutory requirements, including the implementation of TAKS, curbs on social promotion, and the implementation of the Recommended High School Program as the default high school program.
- **Public expectations:** The second set of outcomes would be derived from a Deliberative Poll. Researchers would first poll a representative sample of Texans about their views towards public education, with an emphasis on school finance issues. Participants in the poll would then be invited to convene in Austin or Dallas for a weekend to deliberate with each other and to interact with policymakers and education experts. At the end of the weekend, participants would be polled again to measure any changes in their views. The Dana Center and its partners would seek foundation and private support for the Deliberative Poll.
- **Professional judgment:** The third and final set of outcomes for which the team would generate cost estimates would emerge from a modified version of the professional judgment approach. The research team would convene education experts, business leaders, and others to specify educational outcomes that reflect the knowledge and skills required for the 21<sup>st</sup> century Texas workforce.

The use of multiple sets of outcomes would be most distinctive component of the Texas adequacy study, and would for the first time allow researchers and policymakers to make direct comparisons across different conceptions of—and different cost estimates for—public education. In addition, the use of the Deliberative Poll would provide new data on what Texans expect from their public schools—and about how those expectations might change with more information. Finally, the specification of multiple sets of outcomes would allow the research team to shed light on questions about the marginal costs of raising standards.

### **Benchmarking cost-effective schools and school districts**

To date, none of the adequacy studies conducted in other states have included direct estimations of the efficiency and productivity of schools and districts. For example, the “successful schools” approach as applied thus far only yields data about the average spending of different types of schools or districts meeting certain performance thresholds. In the Texas study, however, researchers would investigate the cost-effectiveness of different types of schools and districts.

Besides informing its cost estimates, the team’s findings about schools’ and districts’ efficiency and productivity could potentially be useful in two other respects. First, these findings could be used to establish a system for identifying and rewarding cost-effective schools and districts. Second, additional study of the budgeting and resource allocation practices of these schools and districts would allow researchers to catalogue cost-effective practices for addressing particular challenges, such as dropout reduction or



increasing the numbers and diversity of students completing advanced courses. The Dana Center and its partners would seek foundation support to conduct these kinds of cost-effectiveness studies.

### **Comparing across approaches**

Another distinctive component of the Texas adequacy study would involve the concurrent application—and extension—of two approaches for connecting the financing and performance of schools: the successful schools approach and the statistical approach. Most states lack the necessary data to apply these two approaches and have therefore relied on less direct and data-intensive approaches, namely the professional judgment approach and the comprehensive school reform approach. The Texas study would be able to use the state’s rich data, however, to test standard hypotheses about connections among school finance policy and student performance.

It is possible—although extremely unlikely—that the application of these two approaches to three sets of educational outcomes would converge on a single cost estimate, with a single set of cost adjustments. More likely, it would generate ranges of cost estimates, because each approach is sensitive to different kinds of considerations.

### **Dynamic computer modeling**

In the final phase of the project, the researchers would develop a dynamic computer model that brings its findings into dialogue with the Texas school finance system. This model would allow users to explore potential fiscal implications of the study’s findings and recommendations, including how the costs of implementation might change over time. This part of the project would extend a current Dana Center-led project to develop a dynamic computer model of the Texas school finance system.

## **Summary**

School finance “adequacy” has been in the national spotlight because of studies done and action taken in states like Kansas and Maryland. Some are calling on Texas to do an adequacy study that could become the basis for a new approach to school funding. While “adequacy” is a captivating new topic, no study to date has identified the conclusive definition of adequacy. Some members of the Joint Select Committee on Public School Finance favored having an independent research organization conduct an adequacy study. For a study to have credibility with this Legislature, it must focus on Texas’ standards and performance-based system.

# Chapter Ten

## Conclusion

Since the passage of SB 7 in 1993, which created the current recapture-based system of public school finance, few school finance policy changes have been made, due in large part to the history of legal challenges that brought greater equity to the system. Maintaining a constitutional, equitable system has been the Legislature's primary policy objective in school finance since 1995, when Edgewood IV found the system now known as "Robin Hood" to be constitutional.

Local property tax payers have experienced rapid increases in their tax bills due both to rising tax rates and rising property values. Each biennium the State has invested billions of dollars in new money to keep pace with rising costs as well as funding local property tax cuts, teacher pay raises and health insurance. However, enrollment growth, coupled with rising costs, have placed a strain on the capacity of the current system. The Joint Select Committee on Public School Finance was formed to study the impact of the convergence of rising costs, rising local property taxes and a state share that, while increasing exponentially from a total spending standpoint, has not kept pace with local expenditures as a percentage of total expenditures on public education in the state.

The Committee was presented with five plans to either completely replace the current system or study how to replace it. The Committee considered many changes to the current system that could be accomplished with or without a complete system overhaul. The Committee also reviewed revenue sources and considered how to maximize revenues gained through the current system, such as closing tax loopholes and shifting to a broader tax base.

The charge given to this Committee, which is printed in its entirety in chapter three of this report, was challenging in its breadth and scope. Common themes in both public and invited expert testimony included the need to end the current over reliance on local property taxes to fund public education and the need for the state to support and maintain an adequate, equitable and accountable system of public education.

The Committee, via this report, has attempted to share the findings of this process. The report is formatted as a menu of options, reflecting the hope of the Committee that members of the 78<sup>th</sup> Legislature will be able to use this report as it considers public education funding issues in the coming session.