

**SUBJECT:** Repealing the current school finance system and providing interim funding

**COMMITTEE:** Public Education — committee substitute recommended

**VOTE:** 9 ayes — Grusendorf, Oliveira, Branch, Dawson, Dutton, Eissler, Griggs, Hochberg, Madden

0 nays

**WITNESSES:** For — John P. Connolly, Texas School Coalition; Brock Gregg, Association of Texas Professional Educators; Rod Schroder, Texas School Alliance; Bill Carpenter, Houston ISD; Dave Duty, Austin ISD; David Hicks; Mike Moses, Dallas ISD and Texas Association of School Administrators; David Thompson; Forrest E. Watson, Eagle Academies of Texas; (*On committee substitute:*) Diane Jackson, Spring Branch ISD; John McInnis, Texas Association of School Boards; Lynn Moak, Texas School Alliance; Brad Shields, Texas Smokestack School Coalition

Against — Jerry Barber, Laredo ISD; Jesus H. Chavez, Corpus Christi ISD and South Texas Association of Schools; Paul Clore, Gregory-Portland ISD; Daniel King, Hidalgo ISD and South Texas Association of Schools; Dick Lavine, Center for Public Policy Priorities; Kevin O’Hanlon and Martin Pena, South Texas Association of Schools; Lisandro Ramon, Lyford CISD; Leticia Saucedo, Mexican American Legal Defense and Educational Fund; Mary Ann Whiteker, Texas Association of Mid-Size Schools; (*On committee substitute:*) Paul Colbert, El Paso ISD; Bill Grusendorf, Texas Association of Rural Schools; Wayne Pierce, Equity Center; Hal Porter, Texas Rural Education Association

On — Paul Colbert, El Paso ISD; Wayne Pierce, Equity Center; (*On committee substitute:*) David Thompson; Joe Wisnoski, Texas Education Agency; Ted Melina Raab, Texas Federation of Teachers

**BACKGROUND:** The Texas school finance system has evolved through legislative responses to three decades of legal challenges by school districts and taxpayers. Most notably, Edgewood ISD, a property-poor district in San Antonio, filed four major school-finance lawsuits against the state between 1989 and 1995. Three

times in 20 years, courts declared the system inequitable and unconstitutional. Finally, in 1993, the 73rd Legislature enacted SB 7 by Ratliff and created the current system, which essentially shifts money from property-wealthy to property-poor districts to equalize educational funding. This system has come to be known as the “Robin Hood” plan.

The basic concepts of “equity” and “adequacy” were set forth as constitutional guarantees more than 100 years ago in Texas Constitution, Art. 7, sec. 1. The Texas Supreme Court, ruling in *Edgewood ISD v. Kirby* in 1989 (*Edgewood I*), defined equity as “substantially equal access to similar revenues per pupil at similar levels of tax effort.” In its ruling in *Edgewood ISD v. Meno* in 1995 (*Edgewood IV*), the court acknowledged that the state already had set the standard for adequacy as “an accredited education,” as defined by the state curriculum and tested by the state accountability system.

Education Code, sec. 42.001 outlines state policy with regard to school finance. Sec. 42.001(a) sets forth the state’s commitment to provide a thorough and efficient system, substantially financed through state revenue, that is appropriate to all students’ educational needs. Sec. 42.001(b) sets forth the state’s commitment to maintaining court-ordered equity standards, defined as “substantially equal access to similar revenue per student at similar tax effort.”

The basic structure of K-12 public education financing in Texas is a three-tiered system that ensures a school district equalized access to revenue based on the district’s tax effort. The formulas are designed to “equalize” the effect of low and high property values, because property-poor districts cannot collect as much revenue per penny of tax effort as property-wealthy districts. Two legislative guideposts for equity adopted in the appropriations process for the past decade include a state commitment that 85 percent of students and 98 percent of revenues will remain in an equalized system.

Education Code, ch. 41 sets forth several wealth-equalization options for property-wealthy districts: consolidation with another district by choice or by order of the commissioner; detachment and annexation by choice or by order of the commissioner; the purchase of attendance credits; an agreement to educate nonresident students; or tax base consolidation. Most districts choose to buy attendance credits, which means they send enough money back to the

state to reduce their wealth to no more than \$305,000 per student.

To achieve equity, the current system requires property-wealthy districts (Chapter 41 districts) to deliver property tax revenues to the state in excess of \$305,000 per student. This “recapture” revenue, which is expected to exceed \$2.4 billion in fiscal 2004-05, is redistributed to property-poor districts (Chapter 42 or “Tier 2” districts). About 10 percent of Texas’ 1,000-plus school districts are Chapter 41 districts; the rest are Tier 2 districts.

State aid formulas also account for student and district characteristics. For example, an “average student” in an “average district” is assigned a weight of 1.0, and the weight increases when a district has many students in special, vocational, or compensatory education, or many students in gifted-and-talented or bilingual education programs. The weight also increases at the district level according to the Cost of Education Index, district size, and population density in rural areas. The average weighted student ratio is 1.37, but some poorer urban districts and small rural districts have ratios around 2.0. Some Chapter 41 districts have ratios closer to 1.1. Average daily attendance (ADA) refers to a count of unweighted students, while weighted average daily attendance (WADA) refers to a count of weighted students.

Tiers 1 and 2, addressed in Education Code, ch. 42, guarantee a certain level of state funding based on a district’s tax effort, up to a statutory maximum of \$1.50 per \$100 property value. All districts receive a “basic allotment” of \$2,537 per ADA for up to 87 cents of tax effort, then a “guaranteed yield” of \$27.14 per WADA per penny of tax effort between 87 cents and \$1.50.

Education Code, sec. 42.253(b) sets forth the method for estimating Foundation School Program (FSP) payments to school districts. Sec. 42.254 requires TEA in October of even-numbered years to estimate the tax rate and student enrollment of each school district for the coming biennium and requires the comptroller to estimate the total taxable value of all property in the state. This information is updated by March 1 of odd-numbered years.

When actual numbers for enrollment and property values become available, a “settle-up” process occurs, usually near the end of the second year of a biennium. If attendance estimates were too high and property value estimates were too low, this means the state has overpaid. Conversely, if attendance

estimates were too low and property value estimates were too high, this means the state has underpaid. When settle-up money is returned, it frees up general revenue that can be spent on other items. During fiscal 2000-01, property values grew so quickly that school districts ended up returning \$800 million to the state in overpayments, which was spent on the school employees' health insurance program. The Legislative Budget Board estimates that the state will overpay between \$300 million and \$400 million in the current biennium.

Education Code, sec. 45.002, authorizes school districts to levy property taxes for maintenance and operations (M&O). Chapter 45 also sets forth provisions of the Permanent School Fund (PSF) bond guarantee program. In 1983, Texas voters approved a constitutional amendment that allows the state to use the PSF to guarantee school bonds (Texas Constitution, Art. 7, sec. 5(b)). Use of the fund to guarantee repayment in case of district default is intended to make school bonds a more attractive investment and to reduce interest rates and other costs. Currently, about \$26 billion in school bonds are guaranteed by the PSF bond guarantee program.

Tier 3, addressed in Education Code, ch. 46, authorizes equalized debt assistance for school facilities, land, and school buses. The Instructional Facilities Allotment helps qualified school districts pay debt service for new instructional facilities, additions, and renovations. The Existing Debt Allotment helps qualified districts pay "old" debt, currently defined as debt for which a district made payments before September 1, 2001. These programs cost the state about \$1.5 billion in fiscal 2002-03.

Plaintiffs in two recent lawsuits have alleged that because so many districts — currently more than 400 — have reached the nominal \$1.50 cap on M&O taxes, the property tax no longer is a discretionary local tax, but rather an unconstitutional state property tax. In April 2002, the Third Court of Appeals in Austin upheld a lower court decision dismissing a suit by property-wealthy districts, *West-Orange Cove Consolidated ISD v. Alanis*. The court dismissed the case for "lack of ripeness," finding that not enough districts — fewer than half — had reached the \$1.50 cap for the court to consider whether the system has established a state property tax. On March 27, 2003, the Texas Supreme Court heard oral arguments in the case. A similar case is pending in a state district court in Dallas County.

DIGEST: CSHB 5 would repeal the current school finance system, provide interim aid for all school districts, and raise revenues to pay for that interim aid by making the following changes:

- repealing chapters 41, 42, and 46, and sec. 45.002 of the Education Code effective September 30, 2005;
- providing an additional \$100 per ADA for the 2003-04 school year;
- providing an additional \$200 per ADA for the 2004-05 school year;
- delaying August 2005 payments to school districts for one month; and
- avoiding overpayments to the districts in the second year of the biennium.

**Additional state aid.** CSHB 5 would increase the total amount of state aid for all school districts by \$100 per ADA in the 2003-04 school year and \$200 per ADA in the 2004-05 school year. The aid would be in addition to any other state aid and would be calculated based on unweighted ADA. Chapter 41 districts would receive the additional aid as a credit against their recapture payment. If the additional state-aid credit was greater than a Chapter 41 district's recapture payment, the district would keep the difference.

**Repealing the school finance system.** CSHB 5 would repeal chapters 41, 42, and 46, and sec. 45.002 effective September 30, 2005, essentially eliminating the existing system of public school finance. The repeal would not alter the obligation of any school district to issue or pay off any debt that matured after the repeal date. The bill would preserve a school district's ability to levy maintenance taxes after the repeal date, but only at a rate and length of time required to pay off outstanding debt.

CSHB 5 also would assure school districts of continued state assistance under chapters 42 or 46 for bonded debt or lease-purchase transactions entered into before the repeal date, and the education commissioner could not refuse to grant that assistance. A school district could issue bonds, public securities, or other obligations under chapter 45 and could levy, assess, and collect the necessary property taxes to pay those obligations.

**State policy.** CSHB 5 would retain Education Code, sec. 42.001(a), which describes the state's responsibility for providing public education.

**Avoiding overpayments.** CSHB 5 would change the state payment process in the second year of the biennium by requiring the commissioner to reduce state aid payments to school districts in 2005 if their final taxable property values were greater than the amount used to estimate payments.

**Delaying payments.** CSHB 5 would delay the distribution of August 2005 FSP payments to school districts until September 1, 2005.

Except for the statutes to be repealed, CSHB 5 would take effect September 1, 2003.

**SUPPORTERS  
SAY:**

The current school finance system is broken, and nothing less than a sunset of the entire system is required. School districts and taxpayers need action now. So many districts have reached the \$1.50 cap on M&O taxes, it is only a matter of time before the courts declare that school districts no longer have any meaningful discretion in setting local tax rates. The Legislature must set its own deadline, so that all parties can come to the table to craft a fair and practical solution. Otherwise, the courts will declare the system unconstitutional and set a deadline for them.

Deadlines produce results, so voting to repeal the system in 2005 would put legislators on notice that a solution for school finance and tax equity must be found during the interim. The state's tax structure and the school finance system are connected, so it makes sense that lawmakers examine both issues concurrently in a special session. Lawmakers must determine what a public education should cost and what the appropriate state and local share should be, then they must examine the available resources for getting there.

Over the years, the true cost of educating a child has become obscured by special interests, represented by weights in the formulas. Formula adjustments for certain students or districts may have been added for good reasons, but some of the costs they represent have become overstated. This excessive focus on small details, not to mention the complication of factoring numerous tiny adjustments into the formulas, distorts the bigger picture of what a quality education costs.

Lawmakers must find a way to link education funding to both equity and adequacy. Tier 2 forces the state to continue to increase education funding as long as property values are increasing. It does so for equity purposes, but no rational basis exists for the increases in terms of adequately funding public education. Because property values have gone up faster than inflation in recent years, the state has been forced to increase the guaranteed yield at a rate greater than inflation. Now with property values flattening and preparing to decline, districts that are just above the guaranteed yield soon will fall into guaranteed yield territory, leaving the state to make up the difference.

CSHB 5 would provide a needed hedge against inflation for school districts in the form of \$300 in new state aid per student. Distributing the money on an ADA basis would be the simplest and fairest way to show all districts that the state recognized the financial pressure they were under. The Available School Fund and the Technology Allotment also are distributed on an ADA basis, so this distribution method is not unprecedented. Also, it is important to maintain a sense of perspective: this would be only a small part of the total funding for schools for fiscal 2004-05, and in light of imminent changes to the school finance system, it would not be permanent.

The bill would not restrict how new state aid was spent in the coming biennium, thus showing support for and trust in the judgment of local districts. Lawmakers worked hard throughout the budget process to protect formula funding; however, unavoidable budget cuts are planned for specific programs that affect different school districts in different ways, depending on their situations. Therefore, school districts should retain local discretion to tailor the new state aid to suit their individual needs. Because 85 percent of a district's budget is allocated to salary and benefits, it remains very likely that some portion of the additional aid would be spent for those purposes.

One delayed payment at the end of the biennium is a small price to pay for \$1.2 billion in additional state aid. Coming at the end of the biennium as it would, the payment delay should not create an undue burden to districts, since they would have plenty of time to plan for it.

Because funding for CSHB 5 is contingent on the bill's enactment, it is imperative that lawmakers pass the legislation to protect hundreds of millions

of dollars for public schools. If the bill were not enacted, at least \$600 million could be siphoned off to Medicaid or some other budgetary category unrelated to public education.

Overreliance on the property tax is unfair, and local school districts and taxpayers are tapped out. Over the past decade, 70 percent of the new money in the system has come from local property taxes, placing an enormous burden on capital investment in Texas. Since rising property values ultimately benefit the state and not local taxpayers, the state now must be held accountable for its share of the solution and must reduce its dependence on local taxpayers to pay for the state's responsibilities.

Equity is a court-ordered concept and is reflected in the state's constitutional commitment to efficiency. No legislator or property-wealthy district wishes to take equity gains away from property-poor districts, and it is very unlikely that lawmakers would use this bill as an opportunity to do less for children. Texas ranks fifth in the nation in equity, and equity will remain a shared goal with any new school finance system. Also, the state has a constitutional and legal commitment to equity that could not be overturned or trumped by legislative changes.

Extensive language has been added to the committee substitute to reassure the bond market that school districts could continue to levy taxes and receive state aid to meet their obligations with regard to bonded debt. Bond counsel has reviewed the bill, and all their concerns have been addressed. Uncertainty would exist whether the system were reformed or not, so fears that CSHB 5 would precipitate economic ruin are exaggerated and misdirected.

Whether a new school finance system took effect in May or September, school districts would continue to receive payments. Every year, funds are distributed based on estimates, followed by a settle-up process. The process would be no different under a new system, and even if a new plan did take effect midway through a school year, only the settle-up process would change for the first year of the new plan. School districts and taxpayers have sought relief for a long time, so there is no reason to delay implementation.

**OPPONENTS  
SAY:**

The current school finance system is doing exactly what it was designed to do: provide equitable access to an adequate education. As a result, Texas is

nationally recognized for its equity and performance gains. CSHB 5 would not commit the state specifically to protecting equity gains made over three decades and four state Supreme Court decisions. Thus, the general fear about this bill is not uncertainty about the future, but a return to inequities of the past. Any new system would not have been tested by the courts, and it could take another decade of litigation to get back to a place of equity.

If the financing provisions of CSHB 5 are a sign of the times ahead, Tier 2 districts have reason to be concerned. With the stated goal of simplicity, CSHB 5 would distribute \$1.2 billion outside of the school finance formulas, thus shortchanging many Tier 2 districts. Simplicity is a naive goal for a \$30 billion funding system that covers such a variety of school districts and economic conditions.

It is unfair to label certain children or certain districts — who are represented by the weights in the formulas — as “special interests.” Weighted adjustments in the school finance formulas should be maintained to protect all children, regardless of their abilities or where they live.

CSHB 5 would raise \$800 million in revenue by delaying the August 2005 payment to school districts until September 1, 2005. This one-time accounting trick would put school districts in a difficult financial position at the beginning of a school year. Also, the bill would provide no guarantee that the delayed payment ever would be restored to district budgets in the future.

While school financing relies too heavily on the property tax, providing only one penny of property tax relief would cost the state \$100 million in new revenue. Ten cents of property tax relief would cost \$1 billion. The state cannot decouple taxes and school finance, nor can it save its way out of the problem. Therefore, the real focus at this point should be on revenue capacity, or restructuring the state’s tax system. Leaving the current school finance system intact during tax restructuring would protect equity while allowing lawmakers to tackle the difficult process of developing a better plan that would pump more money into the system.

Because a rise in property values creates diminishing returns for local school districts, the Legislature should make a serious commitment to paying a fixed majority state share of public school funding. In recent years the state’s policy

commitment to pay a majority state share has become an empty promise. In the current appropriations to FSP proposed by the House-passed version of HB 1, the state's share is well below 40 percent, and by 2005, only 77 percent of students will be in an equalized system. Rather than making symbolic statements, the state should honor its policy commitments.

No amount of language in the bill attempting to reassure the bond markets can disguise the fact that repealing the school finance system would cast a cloud over Texas bonds to affect rates and costs. The biggest bond buyers are not necessarily Texas firms, but instead are national insurance companies and mutual funds. If a Texas AAA bond were up against a California AAA, and no cloud was hanging over California, Texas bonds would lose out. Although CSHB 5 would not repeal the PSF bond guarantee program, bond buyers also look at a school district's overall ability to raise local revenue and make debt payments. Therefore, the repeal of Chapters 41 and 42 alone could unsettle the bond market.

OTHER  
OPPONENTS  
SAY:

CSHB 5 should move the sunset deadline back a year to September 2004 so that the "drop dead" date would occur before the next state election. During the 2001-02 interim, a joint select committee spent more than a year studying school finance and came up with no recommendations. The Legislature should not get another "bye" on this issue. Taxpayers are overburdened, and Texans cannot afford to wait until 2005 for a solution.

CSHB 5 would remain silent on when a new school finance system would take effect. Therefore, if lawmakers enacted a funding system during a special session in September 2005, it could take effect immediately with the 2005-06 school year. This could be extremely disruptive to school districts that already had planned their expenditures for the school year. The bill should include a clear effective date and a process and timeline for getting there.

NOTES:

As introduced, HB 5 would have raised the equalized wealth level to \$315,000 and the basic allotment to \$2,637. It also would have guaranteed to districts a revenue gain of no less than 3 percent in 2004 and 2005 relative to 2003. The introduced version of the bill would not have repealed the school finance system.

During second reading consideration of CSHB 5 on April 24, the bill was recommitted on a point of order. The version of CSHB 5 reported by the committee on April 24 is identical to the version originally reported.

Dozens of bills and joint resolutions have been filed that would alter the school finance system in some way. Some bills simply would change one element of the school finance system, like HB 251 by E. Jones, which would raise the equalized wealth level to \$330,000, or numerous other bills that would alter specific weights in the school finance formulas. Other bills propose interim relief for school districts without repealing the entire system, like HB 1062 by Bonnen, which is nearly identical to HB 5 as filed, except that it would raise the equalized wealth level to \$325,000 and the basic allotment to \$2,737.

A sampling of other bills dealing with repeal of the school finance system include:

- HB 232 by Eiland, which would repeal Chapter 41 and direct the education commissioner to come up with an alternative plan by January 1, 2004;
- CSHB 604 by Grusendorf and its companion, SB 329 by Shapiro, which would repeal Chapters 41, 42, 45, and 46 effective September 1, 2005;
- HB 3382 by Merritt, which would repeal Chapters 41, 42, and 46, and require the state to fund only teacher salaries and facilities; and
- HB 3370 by Garza, which would void any bill that repealed Chapters 41, 42, 43, 45, or 46 unless it received a two-thirds record vote and proposed an alternate school finance system that met equity standards.

At least seven floor amendments will be offered that are acceptable to the author, including:

- an amendment by Rep. Branch moving the proposed repeal up a year to September 1, 2004, from September 30, 2005;
- an amendment by Reps. Hardcastle and Gutierrez requiring a “fail-safe” plan such that the state would revert back to the current school finance system if an alternative were not found by September 1, 2004;

- an amendment by Rep. Oliveira adding a statement that the school finance system should provide substantially equal access to similar revenues per student at a similar tax effort, taking account of legitimate student and district cost differences;
- an amendment by Rep. Christian distributing \$10 million per year in funds that would be appropriated to small school districts in the House-passed version of HB 1, based on the districts' ratio of WADA to ADA. This amendment would apply only to Chapter 42 small and mid-sized districts;
- an amendment by Reps. Luna and Pitts, et al., protecting teacher salary and benefit gains through the 2002-03 school year, including the \$1,000 passthrough for health insurance, essentially holding harmless all certified school employees (teachers, librarians, counselors, and nurses) from salary reductions;
- an amendment by Rep. Laubenberg extending for one year a provision pertaining to the calculation of the wealth per student of districts not serving all grades; and
- an amendment by Reps. Eissler and Kolkhorst enabling the education commissioner to use funds that would be appropriated in the House-passed version of HB 1 for one additional year of facilities debt assistance.

A number of other amendments also could be offered, including but not limited to:

- requiring the Legislature to outline a process for deciding on and implementing a new school finance system;
- requiring all of the new state aid to be distributed through the formulas (based on WADA);
- requiring that enough of the new state aid be distributed through the formulas to keep 85 percent of school children in the equalized funding system; and
- requiring specific guarantees to protect equity gains for Tier 2 districts achieved to date and/or future equity in any alternative system.