

InDepth

Understanding Texas School Finance



Politics: The Art of Possible

We understand we are heading into a session where the state is facing truly unprecedented challenges. From a financial perspective, the comptroller has already announced that in the current biennium we are facing a \$4.58 billion deficit. This budget hole must be filled by the legislature before state funds are allocated to the next two-year budget.

We also know the Texas Education Agency has requested full funding for the Foundation School Program in their Legislative Appropriations Request. This seems to indicate that TEA and state leadership are **prioritizing the reforms made in House Bill 3**. It is our job to ensure that this is a legislative imperative and to provide elected officials with the information they need to guarantee the full funding of the Foundation School Program.

Aside from these overarching fiscal constraints, navigating the opening of schools and the state economy in the midst of the pandemic poses problems that no state leaders have ever faced. We know that this pandemic has caused logistical issues for both schools and the state, with the delivery of instruction varying from district to district, and state legislative operations essentially grinding to a halt with a high degree of uncertainty as to how the legislature will function beginning in January.

Success this legislative session may very well be defined by simply holding onto the progress and funding increases in House Bill 3. However, while these challenges may preclude the availability of additional funding for public education for the upcoming biennium, it should not keep us from continuing to discuss what needs to be addressed by the legislature in the future, such as the state's need to more adequately fund school district bonded debt.

The Texas Public School Finance Commission and subsequent House Bill 3 experience should be the perfect reminder that we cannot afford for the various aspects of our public school finance system become outdated, such that they no longer serve their initial purpose.

In light of these issues impacting both schools and the legislature, **let's take this time to begin discussions around issues such as I&S funding reform to educate, highlight and inform as we work toward finding ways to address various aspects of our funding system, now and in the future.**

We know what is possible, the legislature has the tools available to fully fund the promises that were made in House Bill 3. The issue is, does the political will exist to use these tools. Being armed with the right information and consistently and respectfully engaging our elected officials is the best way to navigate these challenges and have a successful legislative session that results in full formula funding for every school district.

Let's Talk Facilities Funding!

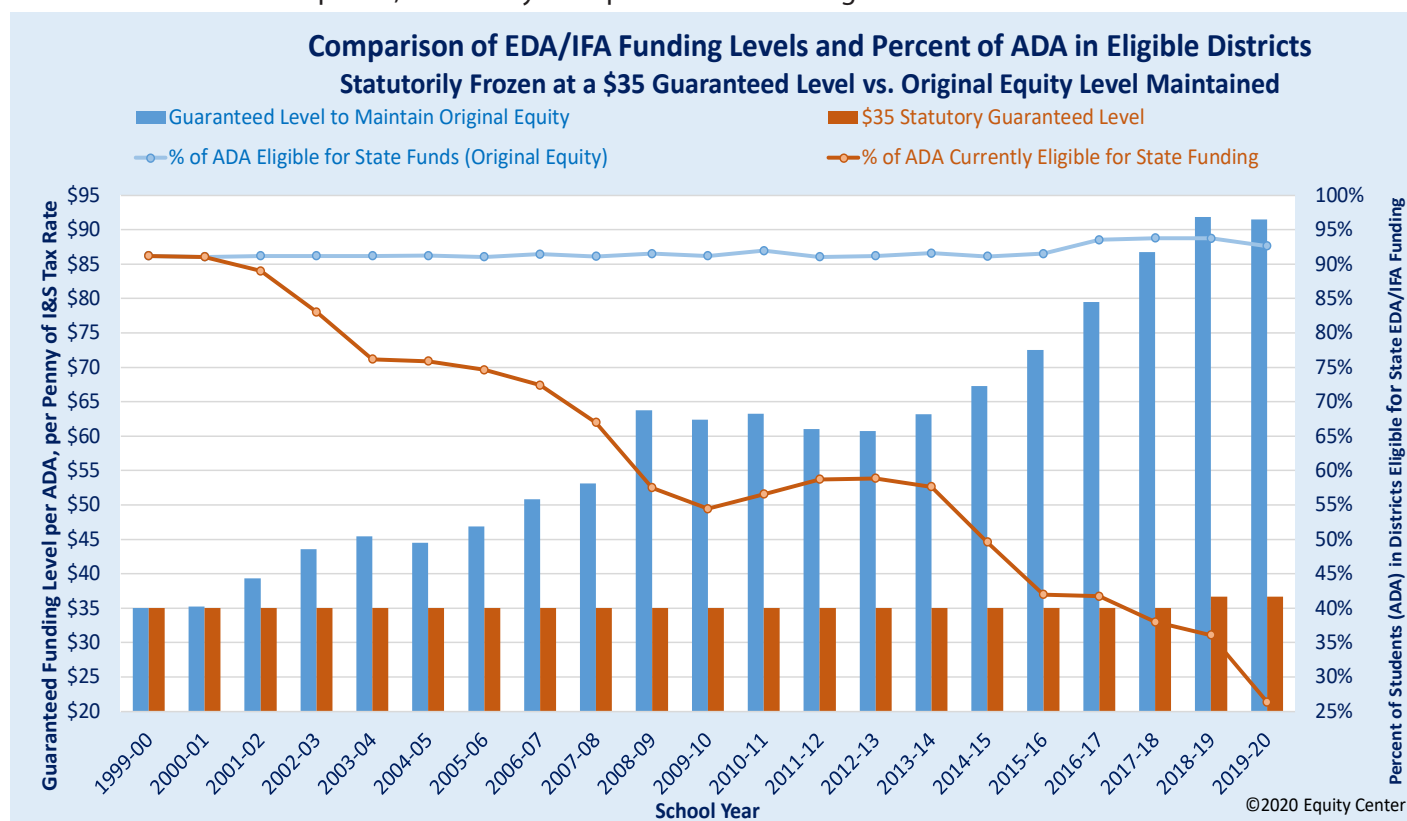
Why the current state facilities funding programs need to be fixed:

In one form (a type of grant) or another (formula funding), state support specifically directed towards the costs of providing instructional and other facilities for public schools has been a part of Texas' system since 1995. (Look for a detailed history of Texas' attempts to fund school facilities as part of the new "White Paper" on facilities funding the Equity Center will publish later this year or in early 2021).

Those original attempts in the late 1990s have remained largely unchanged or updated, either in funding level or mechanics. Because school funding needs, and especially facilities funding needs, are ever changing, a system that is supposed to meet those needs must also change and adapt to new concerns and problems.

Texas' current facilities funding system is dormant, and has been allowed to remain so to the point of becoming ineffectual and of little or no value for the vast majority of Texas' children, taxpayers and school districts.

In order to illustrate those points, we invite you to peruse the following charts:



The vertical axis on the left is expressed in funding levels per student in average daily attendance (ADA) per penny of dedicated bond payment tax effort (I&S). The vertical axis on the right reflects the percentage of students in Texas. The horizontal axis at the bottom shows each school year from the 1999/2000 school year—when the Existing Debt Allotment was put into place—to the 2019/2020 school year.

The red and blue columns on the graph reflect the guaranteed level per law (red) and the guaranteed level as it should have been (blue) to maintain 91% of public schools students in districts qualifying to receive state assistance to pay their bonded debt. The red and blue trend lines highlight the actual percentage of students in districts qualifying for state assistance to pay bonded debt each school year (red) and the percentage of students that would have been in districts qualifying to receive state assistance for bonded debt payments had Texas maintained its original commitment of at least 91% of students in districts qualifying for state assistance to pay bonded debt (blue).

They say a picture is worth a thousand words. This one may be worth more! However, the simple truth it illustrates is that a plan that started with the promise of substantial state assistance for districts that would enable them to afford the bonded debt necessary to pay capital expenses and construct adequate instructional facilities in a highly efficient

Facilities Funding... continued

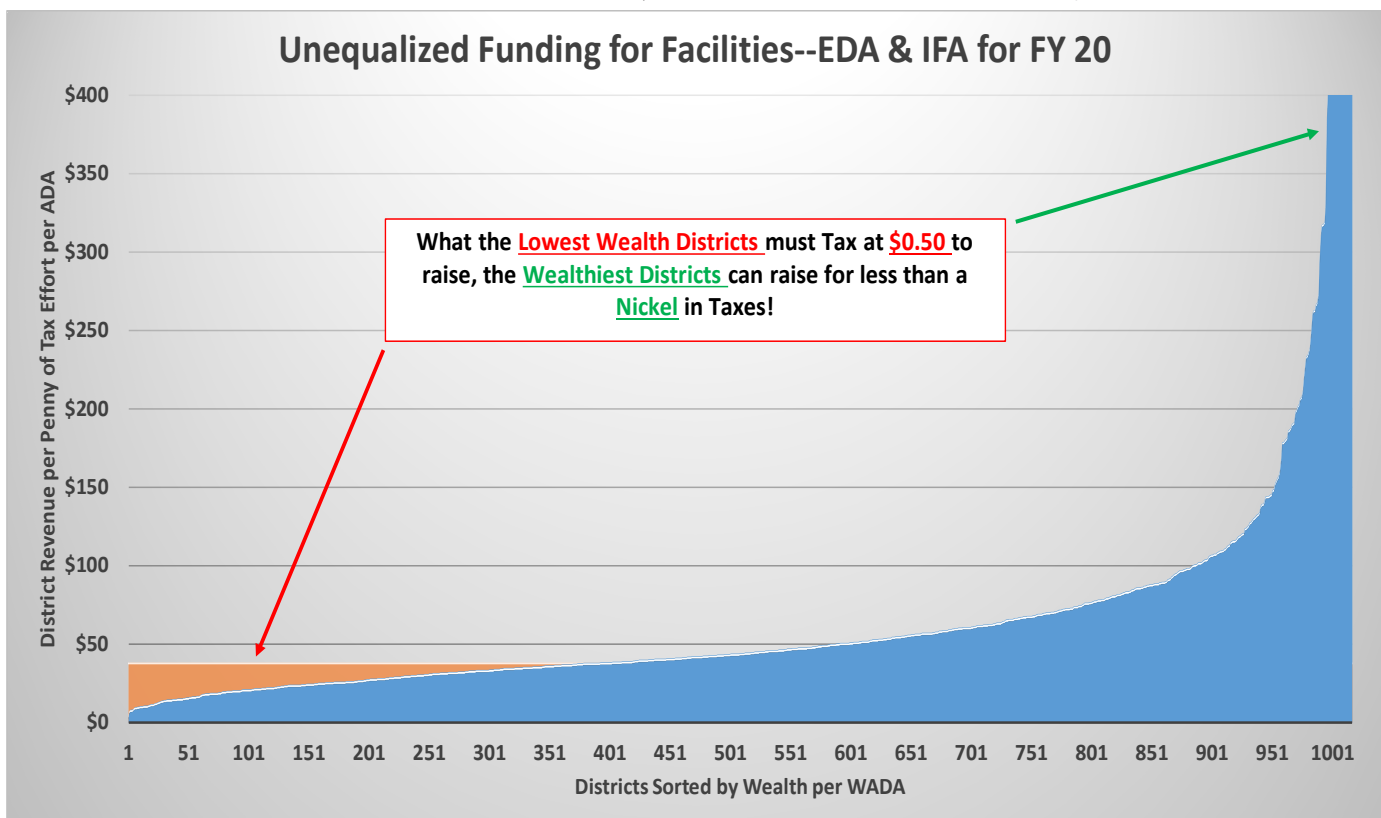
and equitable manner in 1999, has basically been ignored and left to wither on the vine. As a result of our basic failure to increase the guaranteed yield per ADA from the original \$35 to match the growth in construction costs and local property values, the state share of paying for public school bonded debt has declined from helping districts with 91% of our students in them, to a point where state assistance now impacts barely 25% of students.

“Kick the Can down the Road” may be a fun game for elementary age boys, but when it becomes—for whatever reason, intentionally or not—legislative policy, it results in abject failure when applied to address the facilities needs of public school children in a state that has experienced the rapid student population growth that Texas has over the last 20 years.

There are two basic purposes of state assistance to school districts to pay bonded debt:

One is the recognition that school facilities are an integral part of providing adequate educational resources in today’s global economy. As a result, just as the state shares in the cost of providing daily instruction and all that entails, the state must also share in the cost of providing adequate and appropriate facilities in which that instruction can take place. The constitutional requirement to provide for the “general diffusion of knowledge” is a charge to the state.

The second, and equally important purpose of state assistance to school districts for the payment of bonded debt, is the recognition of the fact that local district property wealth is not equally distributed across the state in relation to where children reside. As the chart below shows, the 1,000 plus school districts in Texas have widely disparate levels of wealth per student. And as a result, enormous differences in local abilities to pay for the bonded debt needed to build the facilities required to appropriately educate the students in their charge.



The vertical axis shows school district revenue available per penny of tax effort per student in average daily attendance (ADA). The horizontal axis reflects the school districts of Texas according to their property wealth per WADA (student in weighted average daily attendance). The district with the lowest wealth per student is the left at number 1 and the wealthiest districts are shown on the far right. The blue portion of the chart reflects what each local school district can raise per ADA per penny of tax effort. The orange portion shows the state assistance that guarantees schools a minimum of at least \$35 per ADA per penny of tax effort.

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Facilities Funding... continued

As the chart on page 3 demonstrates, in the school year 2019/2020 there were a little over 300 low wealth school districts that qualified for some state assistance for bonded debt. And for those districts, especially those on the far left of the chart, without even that minimal level of state assistance, constructing even the barest of school facilities would be impossible.

More importantly, the chart dramatically demonstrates the inefficiency and inequity of the state's determination to depend extensively on local property wealth to fund needed school facilities. Not only, as shown in the earlier chart, has the guaranteed level of \$35 per ADA per penny of tax effort failed to keep up with the ever increasing cost of construction and student population growth, the fact that it has remained essentially stagnate for 20 years has resulted in an ever widening gap in ability to build need facilities and the local tax effort required to accomplish the task.

As the text box in the chart shows, anytime the state's funding system allows some districts access to the same amount of funds and fiscal resources for a nickel or less of tax effort that requires other districts to charge \$0.50 cents of tax effort to access, that system has grown way out of kilter.

The state constitution requires the legislature to provide for an "efficient system of free public schools" for the purpose of providing for a "general diffusion of knowledge." The state Supreme Court has on multiple occasions interpreted "efficient" to mean substantially equal resources for substantially equal tax effort. As the charts show, the current circumstances surrounding how we now finance and pay for facilities is terribly skewed, inefficient and inequitable. ***It needs to be addressed and plans developed to permanently and efficiently tackle and solve these problems.***

We call it "The Texas Plan: Part 2." <see *Taking Charge of Facilities Funding* on page 6>



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Taking Charge of Facilities Funding: The Texas Plan, Part 2

Historically, state funding assistance for the construction and renovation of public school facilities has primarily been a local property taxpayer responsibility through an Interest & Sinking (I&S) tax rate. While districts could legally use certain state funds to make debt payments, doing so came at the expense of the Maintenance and Operations (M&O) budget. For example, the state allowed the use of funds from the per capita distribution from the Available School Fund for both M&O and I&S but using those funds for debt payments resulted in a corresponding reduction in funds available for the M&O budget.

With significant disparities in taxable wealth available to districts, some could build first-rate facilities and pay for them with only a few pennies of an I&S tax rate. At the same time, and potentially next door, another less-fortunate district might build only rudimentary, inadequate facilities at significantly higher I&S tax rates or be forced to forego building improvements at all.

Beginning in 1984 with House Bill 72, a landmark legislative improvement in foundation school funding, the state began to specifically build facilities capability into the Enrichment Equalization Allotment, which districts could use for both I&S and M&O purposes. However, having the legal ability to use the allotment funding in this manner did not make limited funding sufficient for both M&O and I&S purposes.

Over the following decade, the state authorized many interim studies of varying stripes to come up with some method of providing state assistance for facilities. Regardless of recommendations, the state could not get out of the state facilities funding rut, except for a few improvements here and there. All through these years, while the legislature liberally made it allowable to use state funds for debt payments, **there were no state funds allocated explicitly for facilities, and what was available always came at the expense of funds available for M&O.**

Despite the Texas Supreme Court ruling, this tendency endured that an efficient state funding system must include equalized funding for facilities. Then, in 1995, a significant change occurred when the state added a new School Facilities Assistance Program in which state grants dedicated to the purchase and construction of instructional facilities.

In the following session (1997), the state replaced this limited system with the first Instructional Facilities Allotment (IFA). While still lacking in many respects, the IFA program was a significant improvement, but far less than the new version of IFA adopted in 1999. The state also created a new Existing Debt Allotment (EDA) that addressed facilities debt not covered by the IFA. **This combination of EDA and IFA was a sea-change from previous legislative efforts**, except for a vast backslide in which the state excused wealthy districts from any recapture obligation, resulting in a substantial loss of the efficiency that IFA and EDA offered.

Although the state continued to make small, though essential improvements through the 2009 legislative session, further improvements have come to an almost complete standstill for the next ten years. Specifically, funding for new IFA projects has almost completely stopped (one appropriation out of ten years). Furthermore, perhaps most importantly, the state has failed to increase the funding level from the original \$35 per ADA (per penny of tax effort) guaranteed yield level even in the face of a growing student population and ever-rising costs of land purchases and facilities constructions, other than a \$3.10 increase in the guaranteed yield level in the 2017 legislative session. In its current form, low- and mid-wealth districts, especially those that are fast-growth, are being pushed to higher and higher I&S tax rates. The combination of M&O tax rates comparable to other districts and especially onerous I&S tax rates is unfair to these districts. The current system has also become increasingly inefficient and inequitable in that districts within the system must tax at the \$0.50 attorney general's I&S tax cap in order to fund what the very wealthy districts can do with only a nickel.

Due to these shortcomings, **the Equity Center put together a small study group of school finance practitioners to develop the next step in facilities funding** and, hopefully, the much-needed companion to the 1999 session's House Bill 3 Texas Plan. In the resulting "Texas Plan, Part Two" (which we hope to have printed and distributed in late 2020/early 2021), the study group numerates the significant problems in the current IFA/EDA system and presents a series of efficient, cost-based, and common-sense solutions to existing problems.

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Taking Charge... The Texas Plan, Part 2... continued

We encourage interested parties to read the resulting paper (coming soon!) to learn important foundational specifics not included in this abstract and examine the thoughtful changes the study group recommends to the Equity Center Board of Directors for inclusion in its 2021 Legislative Priorities Plan. The following is a brief synopsis.

The new facilities funding program should include these elements:

1. Do no harm during the implementation process.
2. Continue the current practice of allowing local boards of trustees to determine the scope of projects and local voters to ratify those selected projects.
3. Replace the EDA and IFA with a single, simplified, and encompassing funding system.
4. Remove arbitrary caps on the number of equalized I&S pennies.
5. Create a full partnership of state and local funding from year one. There should be no biennial lags.
6. Ensure that every new state dollar results in a dollar of tax relief common knowledge so legislators can justify any cost increase to the people they represent.
7. Create a dynamic funding level that keeps pace with the increase in demand caused by student growth over time and any associated costs.
8. Make the new Texas Plan consistent, dependable, transparent, and taxpayer-friendly.
9. Remove "gotcha" funding surprises that reduce the state's share of responsibility at the expense of a more significant burden on the shoulders of Texas taxpayers.
10. Ensure that districts can fully depend on the state delivering 100% of its share.
11. Simplify the funding formula so people can understand it.
12. Provide appropriate avenues of phasing in provisions in recognition of the current financial climate.

The improvements here are significant but incomplete. The full white paper (coming soon!) provides greater detail and additional elements. *Email or call today to join or sponsor the Equity Center! info@equitycenter.org*

Protecting HB 3 and Looking Ahead

House Bill 3 of the 86th Legislature, the major education and school finance reform legislation was a landmark achievement. Not only did it infuse enough new funding into public education to more than erase the impact of the devastating cuts of 2011, HB 3 also made important structural changes in the way we fund public education in Texas. A detailed description of those changes can be found in the Equity Center June 2019 & June 2020 InDepth.

However, HB 3 was adopted during a growing economy that had produced sizable surpluses which became a major source of funding for the proposed program improvements. In addition to reallocating substantial amounts from previous funding streams, over \$6 billion in new revenue was appropriated to fund the new funding elements and increase in the basic allotment and more than \$5 billion in new revenue was dedicated to fund several property tax reduction measures that were also part of the bill.

While the expected revenue stream for the 2020-21 fiscal year would have covered some of that more than \$11 billion increase, a significant portion was financed with surplus revenue from the preceding biennium. The lack of future funding streams to pay the full cost was criticized at the time, a criticism that has been borne out by the impact of this year's recession. The 2019 session ended with an expected surplus of \$2.9 billion for the next session. Instead, the most recent estimate is that legislators will face a \$4.6 billion deficit that will have to be immediately filled when they convene in January. That deficit would have actually been \$4.1 billion bigger but that amount was offset by a combination of higher than expected property value increases, which reduced the expected cost of the Foundation School Program (FSP), and over \$1.1 of federal aid from the CARES Act that was substituted for state general revenue.

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Protecting HB 3...continued

Not only will legislators have to address that immediate deficit, there are two additional hurdles to overcome. It remains to be seen if the economy either has recovered or will be expected to recover sufficiently to match the expected costs of state programs besides education, including health care, public safety and all the other services we depend on. In addition to those costs, there also are billions of dollars in unexpected costs related to the pandemic. Some, but not all of those were covered by the CARES Act. It remains to be seen if the upcoming Congress can come together to do what they failed to do the latter half of this year – pass an additional Cares Act to address both the individual economic losses most Texans have incurred and the economic losses and higher costs that states and local governments have endured and are continuing to endure.

Protecting the Gains: Where will the money come from?

If the revenues projected in January for the coming biennium (the state adopts a 2-year budget) are not sufficient to fully fund the HB 3 changes, a likely battle in the upcoming session will be which part of HB 3 – the education improvements or the tax reductions – will have first call on what funds will be available. That will depend significantly on the strength of the education community's advocacy.

Of course, the more revenue available, the smaller that battle will have to be. Because the economy is cyclical, the Legislature has developed a number of resources to draw on when the economy turns down. Here are some of the major potential sources:

- **The Economic Stabilization Fund** (“ESF,” also known as the Rainy Day Fund) – the demand for state services increases in an economic downturn, while state revenues decline. After a severe recession in 1986, the Legislature created the ESF in 1989 to enable current services to be maintained. The ESF is projected to contain \$8.8 billion next biennium, and while there are restrictions on its use, some or all of that is potentially available to erase the deficit and potentially help meet the other ongoing needs. In fact, a simple majority vote of the legislature can change the floor.
- **“Smoke and Mirrors”** – the state constitution does not actually say that the budget must be balanced, merely that the state comptroller certifies that there will be sufficient revenue to fund expenses that are expected to be paid in the two years between September 1 following the regular legislative session through August 31 two years later. In many previous downturns, legislation has been passed making bookkeeping changes – primarily delaying payments due at the end of that biennium until the next month (September), changing them into expenses for the subsequent biennium. School officials are familiar with these tactic – school payments and payments to the retirement systems have frequently been delayed to help “balance” the state budget. Depending on which of these are utilized, there are several billions of dollars they can provide.
- **Tax Exemptions** – while it is unlikely that the Legislature will do what some previous legislatures have done during recessions and raise state taxes, there are billions of dollars in exemptions from existing taxes. Many, perhaps most, still serve the beneficial public purposes for which they were created, but some have possibly continued despite the need no longer existing. A thorough review of current exemptions could identify potentially billions of dollars in revenue that could be of better use paying for education and other important needs rather than providing unneeded subsidies and tax advantages that serve no general public purpose.
- **Fees** – While a general increase in fees is also not likely, it is possible that the Legislature will review fees that are intended to pay for specific state programs and determine whether the current fees are sufficient or taxpayers are subsidizing those programs. While not likely to generate amounts of the magnitude needed, fee such increases might generate several hundred million dollars that could contribute to preserving educational improvements.

Improvements to HB 3:

As we have said, House Bill 3 was landmark legislation that made significant improvements to the system of financing Texas public education. Many of those were developed and recommended by the Equity Center. However, like any major restructuring of a complicated system, there are areas that could have been done better or issues that were left unaddressed. Here are some of the improvements we would like to see made in the coming legislative session.

Fixes:

- HB 3 has been lauded for putting all districts into a single, uniformly applied school finance system, ending decades of treating property-poor districts differently and disadvantaged compared to their wealthier neighbors. One example was the treatment of the local option homestead exemption (LOHE). *Cont'd page 10*

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Protecting HB 3... continued

For decades, all districts were treated the same, with a special legislative appropriation or a surplus in funding for the FSP required to cover half of the cost of LOHE for all districts. In 2017, a new interpretation by TEA resulted in state taxpayers picking up half the cost of local decisions by wealthy school districts to offer an additional homestead exemption of up to 20% of taxable value, while denying that same benefit to taxpayers in property-poor districts. HB 3 purported to treat all districts the same, but an amendment added in conference committee has now been interpreted by TEA to potentially guarantee wealthy districts state receive revenues to cover all of the cost of granting this optional exemption. This interpretation is contrary to the explanations given at the time by the bill's authors and needs to be corrected so that all districts and taxpayers are treated the same.

- Since 1984, Texas has recognized that some uncontrollable differences in the cost of education occur between school districts, while others occur between students, even when they are in the same district. One primary source of district-level differences is the diseconomy of scale for school districts that are too small to achieve optimum size for classes and programs and that face district-level costs per student that are much higher than for larger districts. Unfortunately, HB 3 ceased recognition of district-level cost differences. The formula adjustments for diseconomies of scale were preserved, but they are now only applied as student-level adjustments to funding of the regular education and special education programs. Diseconomies of scale impact the rest of education as well and the appropriate formula adjustments should be applied throughout.
- Any time major changes are made to a finance system, it is appropriate to provide temporary "hold-harmless" adjustments that allow school districts that might lose money to transition to their new funding levels. The operative word is temporary. Too many times in the past, such adjustments have lasted for years or even decades, wasting limited taxpayer dollars on funding levels that are not needed for essential program costs. To avoid this happening again, the transition funding elements in HB 3 should be phased down to provide an "off ramp" rather than a cliff for the few districts receiving these non-cost-based special benefits.
- The Texas Supreme Court established and has repeatedly affirmed that equity in educational funding is mandated by the "efficiency" clause in the Texas Constitution. They set the standard as "similar revenue for similar tax effort". A provision within the HB 3 tax reduction section will violate that standard by providing full funding to some districts at lower tax rates for districts that have higher percentage growth in property values. The constitutional standard must be observed.
- Another key equity principle is that state funding should only reflect cost differences that are beyond the control of school districts. HB 3 has created many new programs intended to address real problems, but it is important to examine them and make sure that funding properly reflects such costs and does not create new inequities.

Unaddressed issues:

As massive as the legislation was, there are still several areas of education funding that were not addressed, primarily due to a lack of sufficient data to design appropriate solutions. The problems are still there and are in need of attention:

- State support for funding of school facilities has remained essentially unchanged for the past two decades. As a result, state funding has decreased from initially funding one-third of these costs to providing for less than 4% of current expenditures. This is both the biggest cause of inequity remaining in the finance system and also the cause of inordinately high property tax rates in many districts, particularly property-poor and fast-growing districts. The system needs an update.
- It is generally recognized that the current method of funding special education does not properly reflect the way those programs are now structured and the costs they incur. Change is needed.
- In addition to eliminating district-level adjustments for diseconomies of scale, HB 3 also eliminated recognition of district level cost-differences caused by differing labor markets and the relative difficulties some districts have in attracting and retaining good teachers. While the funding was eliminated, the uncontrollable cost differences remain.

It may be difficult to make additional changes in the current economic environment. But if there still is insufficient data to develop appropriate formula adjustments to meet these needs, it is imperative that studies are commissioned to provide the necessary improvements in the following session.



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