Bill Analysis

John Rau *Legislative Service Commission*

S.B. 2

124th General Assembly
(As Introduced)

Sens. Jacobson, R.A. Gardner

BILL SUMMARY

- Changes the methodology used to determine the base cost of an adequate education.
- Raises the per pupil formula amount for base-cost funding to $4,566 for FY 2002 and $4,694 for FY 2003, which includes funding for the legislative mandate for additional course units for graduation.
- Establishes a three-mill limit (over and above the 23 mill base-cost charge-off) on the school district share of combined expenditures for special education, vocational education, and transportation.
- Creates a new "Tier II" funding program that provides stipends to all school districts to assist in paying the cost of educational program enhancements.
- Shifts incorporation of an income factor from base-cost funding to the new "Tier II" funding program.
- Repeals the temporary cap on school district state aid.
- Adds transportation costs to the charge-off supplement.
- Repeals the "power equalization" subsidy.
- Requires the Speaker of the House and the President of the Senate, in 2003 (instead of in July of 2000 as under current law) and every sixth year thereafter, each to appoint three members to a committee charged with reexamining the method of calculating the costs of an adequate education.

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CONTENT AND OPERATION

Overview of bill

The bill makes substantive changes to the state's school funding system based largely on recommendations contained in the "Final Report of the Joint Committee to Re-Examine the Cost of an Adequate Education."[1] While it retains much of the current formula for distributing base-cost funding to school districts, it alters variables in the formula to reflect adjustments in the methodology for determining the adequate cost per pupil. The bill also increases the "formula amount" in order to cover school districts' cost of implementing the new graduation mandate imposed in Am. Sub. S.B. 55 of the 122nd General Assembly (1997).

With respect to funding variable costs (categorical funding), the bill places a three-mill cap on the amount of local revenue that a school district must devote to its share of the combined calculated cost of providing special education services, vocational education services, and student transportation and expands the

[1] *That committee and the Joint Committee on Education Funding and Accountability held hearings and reviewed other forms of testimony throughout the last half of 2000 in an effort to develop legislative recommendations for a new school funding system.*

"gap revenue" provision to ensure that the local share of transportation costs is actually available to school districts.

The bill provides a new level of funding (called "Tier II") to provide equalized state aid to all districts to help pay the cost of programs and services "beyond educational adequacy." Under Tier II, each district will receive an amount equal to a fraction of the base-cost formula amount. That fraction is determined based on a sliding scale that varies according to the property wealth and the income potential of each district.[2]

Background

Introduction

In *DeRolph I*, in 1997, the Supreme Court of Ohio ordered the General Assembly to create a new school funding system.[3] In that decision, the Court held that the state's then-current school funding system did not provide a "thorough and efficient system of common schools" as required under Article VI, Section 2 of the Ohio Constitution. Responding to that order, in 1997 and 1998, the 122nd General Assembly enacted several bills dealing with the financing and performance management of public schools.[4]

On May 11, 2000, the Court held the new system unconstitutional on essentially the same grounds.[5] In *DeRolph II*, the Court praised the effort made by the legislature but said that more had to be done in order to comply with its order.

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[2] *See intent language codified in the bill at R.C. 3317.012(D).*

[3] *DeRolph v. State (1997), 78 Ohio St.3d 193.*

[4] *Among these bills were: Am. Sub. H.B. 215, which was the general operating budget for the 1997-1999 biennium; Am. Sub. S.B. 102, which substantially amended the Classroom Facilities Assistance Program and created the Ohio School Facilities Commission; Am. Sub. S.B. 55, which added new academic accountability requirements; Sub. H.B. 412, which changed school district fiscal accountability requirements; and Am. Sub. H.B. 650 and Am. Sub. H.B. 770, which together created a new school funding system. In addition, in 1999, the 123rd General Assembly passed Am. Sub. H.B. 282, which enacted the state's first separate education budget and made some changes to the previous accountability and funding legislation.*

[5] *DeRolph v. State (2000), 89 Ohio St.3d 1.*

The General Assembly now has until June 15, 2001 to come up with a new system.[6]

Key concepts of the current school funding system

State per pupil payments to school districts for operating expenses have always varied according to (1) the wealth of the district and (2) the special circumstances experienced by some districts. Under both the school funding system in place prior to *DeRolph I* and the one in place since then, state operating funding for school districts is divided primarily into two types: base-cost funding and categorical funding.

Base-cost funding. Base-cost funding can be viewed as the minimum amount of money required per pupil for those expenses experienced by all school districts in the state on a somewhat even basis. The primary costs would be for such things as teachers of basic curriculum courses; textbooks; janitorial and clerical services; administrative functions; and student support employees such as school librarians and guidance counselors.

Equalization. Both before and after the *DeRolph* case, state funds have been used to "equalize" school district revenues. Equalization means using state money to ensure that all districts, regardless of their property wealth, have an equal amount of combined state and local revenues to spend for something. In an equalized system, poor districts receive more state money than wealthy districts in order to guarantee the established minimum amount for all districts.

Base-cost funding--state and local shares. The current funding system essentially equalizes 23 mills of property tax for base-cost funding. It does this by providing sufficient state money to each school district to ensure that, if all districts in the state levied exactly 23 effective mills, they all would have the same per pupil amount of base-cost money to spend (adjusted partially to reflect the cost-of-doing-business in the district's county).[7] To accomplish this equalization, the base-cost formula uses five variables to compute the amount of state funding each district receives for its base cost:

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[6] *In 2000, the legislature enacted two other bills also directed at some of the concerns expressed by the Court in its DeRolph II order. Am. Sub. S.B. 272 of the 123rd General Assembly made substantial changes in the school facilities assistance programs. Am. Sub. S.B. 345 of the 123rd General Assembly amended the school district solvency assistance program and modified requirements of some school district mandates.*

[7] *One mill produces $1 of tax revenue for every $1,000 of taxable property valuation.*

(1) The stipulated amount of funding that is guaranteed per pupil in combined state and local funds (formally called the "**formula amount**").

(2) An adjustment to the formula amount known as the "**cost-of-doing-business factor**." This variable is a cost factor intended to reflect differences in the cost of doing business across Ohio's 88 counties. Each county is assigned a factor by statute. The formula amount is multiplied by the cost-of-doing-business factor for the appropriate county to obtain the specific guaranteed per pupil formula amount for each school district.[8]

(3) A number called the "**formula ADM**," which roughly reflects the full-time-equivalent number of district students.

(4) The **total taxable dollar value of real and personal property** subject to taxation in the district, adjusted in some cases to reflect lower levels of income wealth and to phase-in increases in valuation resulting from a county auditor's triennial reappraisal or update.

(5) The **local tax rate**, expressed in number of mills, assumed to produce the local share of the guaranteed per pupil funding. The tax rate assumed is 23 mills, although the law only requires districts to actually levy 20 mills to participate in the school funding system.

Each district's state base-cost funding is computed first by calculating the amount of combined state and local funds guaranteed to the district. This is done by adjusting the formula amount for the appropriate cost-of-doing-business factor and multiplying the adjusted amount by the district's formula ADM. Next, the assumed "local share" (commonly called the "charge-off") is calculated by multiplying the district's adjusted total taxable value by the 23 mills attributed as the local tax rate. This local share is then subtracted from the guaranteed amount to produce the district's state base-cost funding.

Base-cost funding formula. Expressed as a formula, under continuing law, base-cost funding is calculated as follows:

[the formula amount X cost-of-doing-business factor X (the district's formula ADM)] – (.023 X the district's adjusted total taxable value)[9]

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[8] *An increase in the variance in the cost-of-doing-business factors from 11% to 18% is being phased in under continuing law. The phase-in will be complete in FY 2004.*

[9] *R.C. 3317.022(A). In lieu of formula ADM, the Department of Education must use the district's "three-year average" formula ADM if the latter amount is greater that the former one.*

Sample FY 2001 calculation. If Hypothetical Local School District were located in a county with a cost-of-doing-business factor of 1.025 (meaning its cost of doing business is assumed to be 2.5% higher than in the lowest cost county), its formula ADM were 1,000 students, and it had an adjusted valuation of $40 million, its FY 2001 state base-cost funding amount would be $3,604,000, calculated as follows:

$4,294	FY 2001 formula amount
x 1.025	District's cost-of-doing-business factor
$4,401	District's adjusted formula amount
x 1,000	District's formula ADM (approximate enrollment)
$4,401,000	District's base-cost amount
- $920,000	District's charge-off (assumed local share based on 23 mills charged against the district's $40 million in adjusted property valuation)
$3,481,000	**District's state payment toward base-cost amount**
79%	District's state share percentage (per cent of total base cost paid by state

Categorical funding. Categorical, or "add-on," funding is a type of funding the state provides school districts in addition to base-cost funding. It can be viewed as money a school district requires because of the special circumstances of some of its students or the special circumstances of the district itself (such as its location in a high-cost area of the state). Some categorical funding, namely the cost-of-doing-business factor and the adjustments to local property value, is actually built into the base-cost formula. But most categorical funding is paid separately from the base cost, including:

(1) Special education additional weighted funding, which pays districts a portion of the additional costs associated with educating children with disabilities;

(2) Gifted education funding, which provides funds to districts for special programs for gifted children;

(3) Disadvantaged Pupil Impact Aid, or "DPIA," which provides additional state money to districts where the proportion of low-income students receiving public assistance through the Ohio Works First program is a certain percentage of the statewide proportion; and

(4) Transportation funding, which reimburses districts a portion of their costs of transporting children to and from public and private schools.

Categorical funding--state and local shares of special and vocational education costs. The current funding system provides for equalization of special education and vocational education costs by requiring a state and local share for the additional costs. This is determined for each district from the percentage of the base-cost amount supplied by each. For instance, if the state pays 55% of a district's base-cost amount and the district supplies the other 45%, the state and local shares of the additional special education and vocational funding likewise are 55% and 45%, respectively.

State funding guarantee. The current funding system also guarantees every school district with a formula ADM over 150 that it will receive a minimum amount of state aid based on its state funds for FY 1998. The state funds guaranteed include the sum of base-cost funding, special education funding, vocational education funding, gifted education funding, DPIA funds, equity aid (a former subsidy for low wealth districts), state subsidies for teachers with high training and experience, and state "extended service" subsidies for teachers working in summer school.

Changes made by the bill

Methodology used to determine the base cost of an adequate education

(R.C. 3317.012(A) to (D))

In 1998, the General Assembly adopted for the first time an explicit methodology for determining the base cost of an adequate education. From that methodology is derived the formula amount, which is in turn used to determine the amount of state base-cost funding for each school district. The methodology under both current law and under the bill is "outcomes-based." That is, it relies on the premise that, all other things being equal, most school districts should be able to achieve satisfactory performance if they have available to them the average amount of funds spent by those districts that have met the standard for satisfactory performance.[10] The standard for that performance adopted by the General Assembly in 1998 was an "effective" rating in FY 1996 measured against the state

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[10] *The fact that "all other things are not equal" is the rationale behind the "categorical" funding provided for school districts with greater needs for transportation funding, DPIA, special education services, and similar requirements that vary from district to district.*

performance standards.[11] In essence, the General Assembly developed an "expenditure model" by examining the average per pupil expenditures of effective school districts. From the initial group of effective districts, it eliminated "outriders" (the top and bottom 5% in property wealth and the top and bottom 10% according to personal income) and arrived at 103 districts to include in the model. The base cost derived from averaging that group's FY 1996 expenditures, adjusted for inflation, was $4,063 per pupil for FY 1999. The General Assembly phased in full funding of the base cost and, thus, derived a formula amount of $3,851 per pupil for that year.

The bill's proposed adjustments. The bill states that the General Assembly adopts the same basic expenditure model methodology, but adjusts it by eliminating only the top and bottom 5% (instead of 10%) of FY 1996 effective districts according to personal income, which results in a group of 122 districts whose expenditures are averaged. As a result of adding 19 districts to the group of districts in the model, the bill states that the General Assembly has added $57 per pupil to the base cost in FY 1996 dollars, which is $67 per pupil in FY 2002 after adjusting for an annual 2.8% inflation rate.

In addition, the bill states that the General Assembly's analysis reveals that the model districts required on average 19.6 credits to graduate from high school in FY 1996. Therefore, the bill concludes, the base cost paid in FY 1999, 2000, and 2001 reflected the cost of providing 19.6 high school credits. However, beginning September 15, 2001, state law requires that a student earn 21 credits to graduate from high school; thus, it appears that the model districts may need to increase instructional spending to meet the new mandate. Consequently, according to the bill, the General Assembly has added to the base cost an additional $85 per pupil for FY 2002 to cover the cost of the increased instructional requirement.

New formula amount

(R.C. 3317.012(A))

As a result of the changes to the base-cost methodology (described immediately above), the bill states the General Assembly has determined that the base cost for FY 2002 is $4,566 per pupil and for FY 2003 is $4,694 per pupil, the

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[11] *R.C. 3302.02 and 3302.03, neither section in the bill. See also Ohio Admin. Code 3301-50-01. In order for a school district to achieve an "effective" rating, it must meet at least 94% of the state performance standards. To do so, a prescribed percentage of the district's students must achieve a passing score on certain of the state proficiency tests and the district must achieve a prescribed attendance rate and graduation rate.*

latter year's amount reflecting a 2.8% inflationary increase from FY 2002. Under the bill, the formula amount for each fiscal year equals the actual prescribed base-cost amount; that is, the bill does *not* phase in full funding of the base cost.

Base-Cost Formula Amounts – FY 1998 through FY 2004

	Current Law		The Bill	
Fiscal Year	Calculated Base Cost Per Pupil	Actual Formula Amount	Calculated Base Cost Per Pupil	Actual Formula Amount
FY 1998	-----	$3,663	N/A	N/A
FY 1999	$4,063	$3,851	N/A	N/A
FY 2000	$4,177	$4,052	N/A	N/A
FY 2001	$4,294	$4,294	N/A	N/A
FY 2002	$4,414	$4,414	$4,566	$4,566
FY 2003	$4,538	$4,538	$4,694	$4,694
FY 2004	$4,665	$4,665	Not Specified	

New committee to reexamine the cost of an adequate education

(R.C. 3317.012(E))

Current law requires the Speaker of the House of Representatives and the President of the Senate each to appoint three members to a committee to reexamine the cost of an adequate education. The law requires appointments to be made in July of 2000 and in July every six years thereafter. The committee is required to issue its report within six months of its appointment. Such a committee was organized in July of 2000 and its report is the basis of this bill.[12]

The bill requires the Speaker and the President to appoint a new committee to reexamine the cost of an adequate education sometime in *2003* (not necessarily in July) and every six years thereafter. It further requires that the committee issue its report within *one year* of its appointment. Finally, the bill also specifies that the committee appointed in 2003 must reexamine the standards used by the committee appointed in 2000, "consider the appropriateness of other standards,"

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[12] *See note 1 above.*

consider "the number, nature, and level of performance" on any of the standards the new committee adopts, and consider "measures of efficiency."

Limit on local share of special education, vocational education, and transportation costs

(R.C. 3317.022(C) and (F) and 3317.0212(A)(2)(a))

The bill limits the amount of local resources (that is, the total "local share") that must be spent on special education and related services, student transportation, and vocational education services. In any fiscal year, the amount of any school district's total local share for these three categories combined may not exceed the product of three mills times the district's adjusted total taxable valuation. (The three mills worth of resources devoted to these categories is above the 23 mills of local revenue assumed to be applied toward base-cost funding.) After the state and local share percentages have been calculated for a district's expenditures in these categories, any amount of attributed local share that exceeds the three-mill cap (the so-called "excess costs") must be paid by the state.

Charge-off supplement ("gap aid revenue")

(R.C. 3317.0216)

Certain school districts are not able to achieve 23 effective mills to cover their respective assumed local share of the base cost. In other cases, districts' effective tax rates will not cover their three-mill local shares of special education, vocational education, and transportation costs. In such cases, current law provides a subsidy to make up the gap between the districts' effective tax rates and their assumed local shares for base-cost funding, special education, and vocational education. The bill retains this charge-off supplement and it adds transportation funding to the categories to which it applies.

Repeal of the "power equalization" subsidy

(Repealed R.C. 3317.0215)

Current law provides another subsidy to school districts that have effective tax rates for operations above the formula charge-off (23 mills) but have below-average property valuations per pupil. The subsidy (referred to as "power equalization") supplements the amount that such a school district is able to raise from two mills of local property tax, so that the amount it raises locally, combined with the subsidy, equals the amount that a district having the statewide average property valuation per pupil will raise by levying two mills. If a school district qualifies for the subsidy and has an effective operating tax rate of less than 25 mills, the subsidy supplements the amount that the district is able to raise from whatever millage the district has in excess of 23 mills, rather than a full two mills.

The bill repeals this subsidy.

Transfer of the income factor from base cost to Tier II funding

(R.C. 3317.02(T) to (W))

The current funding system adjusts a portion of some school districts' taxable valuation (on which the districts' local share of base-cost funding is determined) to reflect the relative income wealth of the district's residents. This adjustment is only made for school districts where the median income of the district's residents is less than the average of all the school district median incomes in the state. In the case of each district below that median, 4/15ths of the district's taxable valuation is adjusted downward (by a variable amount that reflects the district's relative wealth compared to the other districts). This downward adjustment reduces the size of the local share, thereby increasing the district's state share of base-cost funding.

The bill eliminates this income factor adjustment for base-cost funding. As a result, state base-cost funding for districts with below-average resident income will be calculated on the same basis as all other districts. Their adjusted taxable value, and therefore their local share of base cost, special education, and vocational education, will increase. However, the bill uses income of residents of a school district as a factor in determining payments under the new Tier II funding program (see immediately below).

Tier II program to provide state aid to districts for educational program enhancements

(R.C. 3317.021(A)(6) and 3317.0217; Section 5)

The bill creates a new program (referred to as "Tier II" funding) that requires the Department of Education to pay stipends to all school districts beyond those payments made for base-cost funding and categorical expenditures. Stipends for each district are calculated as a fraction of the base-cost formula amount along a sliding scale that is based in part upon both the relative property valuation of the district and the relative income of the district's residents. Thus, these payments are equalized according to the wealth "capacity" of the district both in terms of taxable property valuation per pupil and the residents' ability to pay taxes. The bill does not restrict how a district may spend any of the moneys allocated under this new program.

In determining the wealth "capacity" of a school district, one-third weight is given to the ratio of the federal adjusted gross income (AGI) of its residents per pupil compared to the state average AGI per pupil.[13] Two-thirds weight is given to the ratio of the district's property valuation per pupil compared to the state property valuation per pupil.[14] Payments are further based on a specified "Tier II payment percentage" of the base-cost formula amount and also take into account the cost-of-doing-business factor for the county in which the school district is located. For FY 2002 the "Tier II payment percentage" is one-quarter of one per cent. For FY 2003 that percentage is one-half of one per cent. The final formula used to calculate payments is:

Tier II equalization factor (which is derived from the district's capacity ratio described just above) X Tier II payment percentage X formula amount for the current fiscal year X cost-of-doing-business factor for the current fiscal year X the district's formula ADM for the previous fiscal year.[15]

Repeal of the temporary cap on state aid payments

(Section 18 of Am. Sub. H.B. 650 of the 122nd General Assembly, as subsequently amended; repealed in Section 3)

Until the end of FY 2002, school districts are currently subject to a cap on the amount of increase in total state aid payments that a school district may receive from year to year for most programs and subsidies. That cap is set at the greater of 112% of the district's previous year's aggregate state aid or 110% of its previous

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[13] A district's income ratio is the (average of federal adjusted gross incomes for all its residents for the three most recent years divided by its formula ADM for the previous year) divided by (the average of the sum of all federal adjusted gross incomes for all school districts' residents for the three most recent years divided by the sum of the formula ADMs for all districts for the previous year) (R.C. 3317.0217(B)(2)).

[14] A district's valuation ratio is the (district's "recognized valuation" for the previous fiscal year divided by its formula ADM for the previous fiscal year) divided by (the sum of the recognized valuations for all school districts for the previous fiscal year divided by the sum of the formula ADMs of all school districts for the previous fiscal year) (R.C. 3317.0217(B)(3)). Recognized valuation is the district's taxable property valuation with the adverse impact of triennial reappraisals of that property phased in (see R.C. 3317.02(I) and 3317.015 (latter section not in the bill)).

[15] The Tier II equalization factor is actually calculated as follows: 5 X (2 – the district's capacity ratio). If the result of this calculation is less than "one" the factor is construed to be "one" (R.C. 3317.0217(B)).

fiscal year's per pupil state aid. Most, but not all, programs and subsidies are included under this temporary cap.

The bill repeals this cap immediately.

Effective date

(Section 4)

The changes made by the bill take effect on July 1, 2001.

HISTORY

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Introduced	01-25-01	p. 88

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