Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: Sub. H.B. 318 of the 128th G.A. **Date**: December 17, 2009

Status: As Reported by Senate Finance & Financial Institutions **Sponsor**: Rep. Sykes

Local Impact Statement Procedure Required: No — minimal cost

Contents: Postpones state personal income tax rate reduction for two years and makes other changes

State Fiscal Highlights

STATE FUND	FY 2010	FY 2011	FUTURE YEARS
General Revenue Fund			
Revenues	$405 million to $416.1 million gain from delay in income tax rate reduction; $1.0 million gain from transfer in from Fund 4A90	$420 million to $428.3 million gain from delay in income tax rate reduction; $1.0 million gain from transfer in from Fund 4A90	- 0 -
Expenditures – Department of Education	$285.2 million increase	$566.3 million increase	- 0 -
Expenditures – Department of Mental Health	$7.35 million increase	$7.35 million increase	- 0 -
Expenditures – State Employment Relations Board	$1.0 million increase	$1.0 million increase	- 0 -
Lottery Profits Education Fund (Fund 7017)			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	$285.2 million decrease	$566.3 million decrease	- 0 -
Unemployment Compensation Special Administrative Fund (Fund 4A90)			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	Transfers out to the GRF totaling $1.0 million	Transfers out to the GRF totaling $1.0 million	- 0 -

Note: The state fiscal year is July 1 through June 30. For example, FY 2010 is July 1, 2009 – June 30, 2010.

- **Personal income tax rates.** The bill delays the reduction in personal income tax rates scheduled for tax year (TY) 2009 by two years. Most (94.35%) of the resulting increase in revenues is retained by the GRF.

- **Foundation funding.** Appropriations from the Lottery Profits Education Fund are reduced $851.5 million for the biennium and appropriations from the GRF for foundation funding are increased by the same amount. Both of the affected line items are in the budget of the Department of Education.
- **Nonpublic school funding.** The bill appropriates up to $29.7 million in FY 2011 and FY 2012 for Auxiliary Services and Nonpublic Administrative Cost Reimbursement contingent on the unobligated GRF balances at the end of FY 2010 and FY 2011. The cash would be transferred at the end of FY 2011 to the Auxiliary Services Stabilization Fund, created by the bill.
- **Construction Reform Demonstration Projects.** Presumably, the three higher education construction projects selected would be those most likely to potentially produce savings under the pilot program created by the bill. The pilot program would cease whenever the designated projects are completed or January 1, 2014, whichever is later.
- **Mental health services.** The bill increases appropriations to GRF line item 334408, Community and Hospital Mental Health Services, by $7.35 million in both FY 2010 and FY 2011. This line item is in the Department of Mental Health budget.
- **State Employment Relations Board.** The bill increases appropriations to GRF line item 125321, Operating Expenses, by $1.0 million in FY 2010 and FY 2011 to $3.9 million in each fiscal year. This line item is in the State Employment Relations Board budget. On the effective date of the bill and again on July 1, 2010, $1.0 million is to be transferred from the Unemployment Compensation Special Administrative Fund (Fund 4A90) used by the Ohio Department of Job and Family Services to the GRF.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2010	FY 2011	FUTURE YEARS
Local Government Funds			
Revenues	$24 million to $24.9 million gain from delay in state personal income tax rate reduction	$25 million to $25.6 million gain from delay in state personal income tax rate reduction	- 0 -
Expenditures	- 0 -	- 0 -	- 0 -
Local Drug Addiction and Mental Health Boards			
Revenues	Up to $7.35 million gain	Up to $7.35 million gain	- 0 -
Expenditures	- 0 -	- 0 -	- 0 -

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- **Local government funds.** Delaying the reduction in personal income tax rates scheduled for TY 2009 by two years increases revenues to the Local Government Fund and the Public Library Fund by 5.65% of the total increase in income tax revenues in the current biennium. These additional amounts would be distributed to counties and other units of local government.

- **Mental health services.** Local drug addiction and mental health boards will likely receive a portion, or perhaps all, of the increase in appropriation to GRF line item 334408, Community and Hospital Mental Health Services, in the Department of Mental Health's operating budget for FY 2010 and FY 2011.
- **All-day kindergarten.** The bill permits school districts to request, and requires the Superintendent to grant, a one-year delay of the requirement to provide all-day kindergarten. Any costs related to this requirement will, therefore, also be delayed.

Detailed Fiscal Analysis

The bill delays the last of five reductions in state personal income tax rates that were enacted in H.B. 66 of the 126th General Assembly. In addition, the bill amends H.B. 1 of the 128th General Assembly to reduce the appropriation from the Lottery Profits Education Fund (Fund 7017), used for foundation funding payments by the Ohio Department of Education (ODE), by about $851.5 million for the biennium and to increase funding for GRF line item 200550, Foundation Funding, by the same amount. The bill makes other appropriation changes, and mandates and sets criteria for three construction reform demonstration projects.

Delay of personal income tax rate reduction

H.B. 66 of the 126th General Assembly reduced state personal income tax rates by 21% in approximately equal increments, 4.2 percentage points each year, over the five years from tax year (TY) 2005 through TY 2009. H.B. 318 delays the last of these rate reductions from TY 2009 to TY 2011, holding tax rates unchanged in TY 2009 and TY 2010 at the TY 2008 levels. The TY 2009 personal income taxes, with returns generally due April 15, 2010, are the main determinants of FY 2010 receipts from this tax. Similarly, TY 2010 personal income taxes correspond to FY 2011 receipts.

LSC estimates that deferring the TY 2009 personal income tax rate reduction until TY 2011 will increase personal income tax revenues to all funds by $429 million in FY 2010 and by $445 million in FY 2011, a total of $874 million for the current biennium. Of these amounts, 5.65% will be paid to the Local Government Fund and the Public Library Fund. This will result in the two local government funds receiving an additional $24 million in FY 2010 and $25 million in FY 2011, a total of $49 million. The GRF will retain the remaining 94.35%, an estimated $405 million in FY 2010 and $420 million in FY 2011, a total of $825 million for the biennium.[1]

These estimates are based on forecasts presented in LSC's testimony before the General Assembly's Conference Committee on H.B. 1 in June, updated to take account of TY 2007 tax data released by the Department of Taxation. The estimates are not adjusted downward for any tax avoidance behavior on the part of taxpayers that might

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[1] These estimates are not adjusted for any delays in collection of the additional amounts owed.

occur in response to retaining the higher tax rates. They also assume indexing of tax brackets for inflation beginning in TY 2010, as provided in current law, unchanged by the bill.

Estimates provided to LSC by the Department of Taxation show somewhat higher gains in personal income tax revenue, on an all-funds basis, of $441 million in FY 2010 and $453.9 million in FY 2011. Out of these totals, the GRF retains $416.1 million in FY 2010 and $428.3 million in FY 2011. The local government funds receive additional amounts of $24.9 million in FY 2010 and $25.6 million in FY 2011.

The bill, in addition, increases the tax credit on returns reporting Ohio taxable income of $10,000 or less from $88 to $93, for TYs 2009 and 2010. Under current law, the $88 credit offsets the maximum tax that would be owed on returns reporting incomes at that level or lower, at the current statutory TY 2009 tax rates, ensuring that those persons pay no personal income tax. The $93 credit offsets the maximum tax that would be owed at the TY 2008 tax rates, held unchanged by the bill in TY 2009 and TY 2010. This change is thus necessary to hold unchanged at zero the personal income taxes owed by persons with Ohio taxable income of $10,000 or less in TY 2009 and TY 2010.

The bill also provides a safe harbor for taxpayers who underpaid their estimated tax payments in TY 2009 because the rate decline previously scheduled for TY 2009 is delayed by this bill. This provision appears to hold unchanged the amount of any interest penalty owed by these taxpayers.

Department of Education appropriations

The bill amends H.B. 1 of the 128th General Assembly to make changes to certain appropriations for ODE. It increases GRF appropriation item 200550, Foundation Funding, by $285.2 million in FY 2010 and $566.3 million in FY 2011 and decreases Lottery Profits Education Fund (Fund 7017) appropriation item 200612, Foundation Funding, by the same amounts. These two appropriation items are both used to fund state formula aid payments to public schools.

Appropriations for chartered nonpublic schools

If the unobligated balance of the GRF at the end of FY 2010 exceeds $190.0 million, the bill reappropriates up to $20.8 million to GRF appropriation item 200511, Auxiliary Services and up to $9.0 million to GRF appropriation item 200532, Nonpublic Administrative Cost Reimbursement in FY 2011, of any unexpended, unencumbered GRF appropriations for ODE remaining at the end of FY 2010. These amounts are in addition to the $112.0 million appropriated to 200511 and the $50.8 million appropriated to 200532 in FY 2011 in H.B. 1.

If the unobligated balance of the GRF at the end of FY 2011 exceeds $30.0 million, the bill requires the Director of Budget and Management to transfer up to $29.7 million, but not to exceed the amount of unexpended, unencumbered GRF appropriations for ODE remaining at the end of FY 2011, from the GRF to the Auxiliary Services

Stabilization Fund, which is created by the bill. The bill then requires the Superintendent of Public Instruction to seek Controlling Board approval to expend the cash in the new Fund for Auxiliary Services and Nonpublic Administrative Cost Reimbursement.

Auxiliary Services include secular textbooks, health services, programs for the handicapped, and transportation services provided to chartered nonpublic elementary and secondary schools. The Nonpublic Administrative Cost Reimbursement is a program that reimburses chartered nonpublic elementary and secondary schools for administrative costs incurred in the performance of state mandates.

All-day kindergarten

The bill permits school districts to seek a delay, until FY 2012, of the current law requirement to implement all-day kindergarten for all students beginning in FY 2011. The bill also requires the Superintendent of Public Instruction to grant the requested delay as long as the request includes a resolution from the district board of education providing its justification for seeking the delay and a plan for the full implementation of all-day kindergarten in FY 2012. Under current law, districts may apply for a waiver of the requirement, which the Superintendent may grant at the Superintendent's discretion. To the extent that school districts may incur costs in complying with the requirement, the bill's delay option may reduce districts' expenditures by postponing these costs or by providing additional time to implement less costly methods of compliance.

The cost of the requirement to provide all-day kindergarten varies depending on the circumstances of the school district. Many districts already provide the service and should, therefore, incur no additional cost and will not be affected by this provision of the bill. Prior to FY 2010, the state provided funding for all-day kindergarten to districts with concentrations of poverty students above the state average. In FY 2009, 129 districts (21.1%) received this funding and provided approximately 50,600 kindergartners with all-day services. This represents a comparatively high percentage of statewide kindergartners (38.2%), since many of the state's largest districts are among these 129. On a survey conducted by ODE as a result of H.B. 190 of the 127th General Assembly, 187 additional districts that were not receiving state assistance for all-day kindergarten reported providing all-day kindergarten services to at least 50% of their kindergarten students, or approximately 22,800 kindergartners (17.2% of the statewide total).[2]

For those districts that are not already providing all-day kindergarten there may be both operating and facilities costs. Presumably, switching from half-day to all-day services is similar to doubling the number of kindergarten students served. For example, in a half-day program one full-time teacher could teach 40 children in one

[2] Some of these additional districts reported charging tuition for all-day kindergarten. H.B. 1 prohibits this practice beginning in FY 2012.

classroom – 20 in the morning then 20 in the afternoon. The same 40 children in an all-day program would require two teachers and two classrooms. A cost may also be incurred in expanding the curriculum to cover more material.

The state's current school funding formula defines an adequacy amount for each school district that is partially based on the number of students in the district. Under this model, the marginal adequacy amount for a "typical"[3] kindergarten student based on FY 2010 assumed salary levels is about $6,100.[4] The marginal adequacy amount is a measure of the increase in the adequacy amount if the district's kindergarten student average daily membership[5] (ADM) increased by one student. Half this amount ($3,050) may be one proxy for the additional operating costs of increasing services from half-day to all-day for one kindergarten student.

The cost of facilities will largely depend on each district's current capacity. A district that is growing may need to add classroom space. A district that is losing students may already have the classroom space available. Continuing law provides districts with facilities constraints the option of using space in child day-care centers for kindergarten classes. This may be a less costly option for districts than constructing new facilities.

Construction Reform Demonstration Projects

The bill requires the Chancellor of the Board of Regents, in consultation with representatives of state institutions of higher education, to designate one construction project at three public institutions of higher education as a Construction Reform Demonstration Project. The chosen projects must meet the following criteria:

- Make use of one of the following alternative methods of construction delivery: manager-at-risk, design/build, design/assist, or general contractor;
- Have a funding plan for all construction costs without relying on any resources from a future capital bill;
- Be prepared for bidding to occur during FY 2010; and
- Have a credible plan to meet or exceed EDGE contracting goals.

Under the bill, the chosen projects are required to use the manager-at-risk, design/build, design/assist, or general contractor construction delivery method. The total expected costs of any project using the general contractor method must not exceed $600,000. All chosen construction projects must receive approval from the Controlling Board. Additionally, all projects participating in the program are required to be LEED

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[3] In this context, "typical" means a student who receives no special services, for instance, special education, LEP services, supplemental services, etc. This calculation also assumes an educational challenge factor of 1.0.

[4] This is assuming the student-to-teacher ratio of 19 to 1 for kindergarten students, but otherwise fully phasing in the components of the model.

[5] ADM is the measure the state uses for the number of students funded in each district.

certified. The bill specifies that this pilot program will cease upon completion of the projects or January 1, 2014, whichever is later.

These alternative construction delivery methods differ from the procedure currently required by Ohio law, referred to as the multiple-prime bidding process, in which separate contracts are bid for architecture and engineering services and for other construction services and materials. These alternative contracting processes may or may not lead to cost savings. However, the Chancellor and institutions would presumably choose projects for which these savings will be likely. In manager-at-risk contracts, the contractor's assumption of risk can potentially benefit public owners, but vendors may also increase bid amounts to mitigate the additional risks they assume. With regard to design/build contracts, integration between the design and construction phases of a project can potentially improve timeliness and efficiency. Similar to design/build, design/assist requires mechanical, electrical, and plumbing contractors to participate in the design phase of the project. The LEED certification requirement in the bill could add some construction costs to these projects.

EDGE requirements

The bill requires each construction project selected under the demonstration project to meet specific goals related to the population of minorities and women in the geographic location of the project under the Encouraging Diversity, Growth and Equity (EDGE) Program. This program is overseen by the Equal Opportunity Division within the Department of Administrative Services (DAS).[6] Specifically, the Equal Opportunity Division would be required to make monthly assessments of each project's progress in meeting these goals. Finally, the bill requires that, each year in which any of the projects remain uncompleted, all participating institutions of higher education must pay a cumulative amount of up to $150,000 to DAS to offset costs the agency incurs in carrying out the requirements of the bill. Presumably, these payments would be deposited into the Equal Opportunity Division Fund (Fund 1880).

Reports on Demonstration Projects

The bill requires the Chancellor to produce semi-annual and final reports evaluating the progress and results of each of the alternative construction delivery methods. The reports must include an analysis of the cost effectiveness and other efficiencies achieved. In order to prepare these reports, the participating institutions must provide the Chancellor with all requested information. This requirement may increase the administrative costs of the Board of Regents and the participating institutions.

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[6] EDGE requirements are goals institutions must meet in the percentage of contracts awarded to economically and socially disadvantaged small businesses.

Department of Mental Health appropriation increase

The bill amends H.B. 1 of the 128th General Assembly to increase the amounts appropriated in GRF line item 334408, Community and Hospital Mental Health Services, by $7.35 million in FY 2010 and FY 2011. This line item funds the Department of Mental Health's operating budget for state mental health hospitals and services purchased by community mental health boards from local providers.

State Employment Relations Board appropriations

The bill increases operating appropriations for the State Employment Relations Board (SERB) in GRF line item 125321, Operating Expenses, by $1.0 million, to $3.9 million, in each fiscal year. This line item is used to pay operating expenses of SERB, which acts as a neutral party in the administration of Ohio's collective bargaining laws as they pertain to public employers and employees. On the effective date of the bill and again on July 1, 2010, $1.0 million in each fiscal year is to be transferred from the Unemployment Compensation Special Administrative Fund (Fund 4A90) used by the Ohio Department of Job and Family Services to the GRF.

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