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R-127-0196

MEMORANDUM

From: Melaney Carter, Fiscal Supervisor
Date: February 5, 2007
Subject: Proposed Constitutional Amendment on School Funding

This memorandum is in response to your request for a cost estimate of the recently proposed constitutional amendment on school funding in Ohio. This amendment has provisions with potential fiscal implications for the state, school districts, and other local governments. Unfortunately, in several instances it is unclear how the amendment will be interpreted if it is adopted, particularly during the first years of its implementation. Given this uncertainty, this analysis provides a cost estimate of certain provisions that can reasonably be estimated at this time and a discussion of the fiscal implications of other provisions that may have various interpretations.

A major provision of the amendment is a requirement that the General Assembly fund the cost of a high quality education for public school pupils from preschool through high school, which cost is to be determined by the State Board of Education. The cost of this provision cannot be determined as it depends on the choices and analyses of the State Board. Instead, an estimate is given of the increase in state aid based on the cost of education established by the amendment in the first year of the transition period; this cost does not include preschool students. Table 1 summarizes this estimate as well as estimates for the proposed property tax exemption and changes to funding for higher education and local governments. All estimates are made based on what the costs would have been in FY 2007.

Table 1: Estimated State Costs of Implementing Certain Provisions of the Proposed Constitutional Amendment on School Funding in FY 2007		
Category	Cost	Key Assumptions
K-12 Education (not including preschool students)	\$1,433.8 million	<ul style="list-style-type: none"> ○ Base cost formula amount = \$5,663 per pupil - 7.2% increase from FY 2006 ○ Local share (charge-off) = uniform 20.0 mills for both base cost and categorical costs ○ FY 2006 state aid guarantee
Property Tax Exemption	\$283.5 million	<ul style="list-style-type: none"> ○ The first \$40,000 of the market value for persons aged 65 or older or persons who are totally disabled are exempted from local contribution taxes of 20.5 mills statewide.
Higher Education	\$45.4 million	<ul style="list-style-type: none"> ○ 5.3% increase from FY 2006
Local Governments	\$79.3 million	<ul style="list-style-type: none"> ○ 5.3% increase from FY 2006 for LGF, LGAF, and LLGSF¹
Total	\$1,842.0 million	

Primary and secondary education

Cost of a high quality education

Under the amendment, each budget biennium, the State Board of Education, in concert with the Education Advisory Commission, which is created by the amendment, determines the "Educational Components of a High Quality Public Education." Following this determination, the State Board certifies the "Actual Cost of the Educational Components" for each year of the next budget biennium.² Assuming the amendment is adopted in FY 2008, these determinations will first be made for FY 2011. The cost of the amendment starting in FY 2011 as it relates to the cost of a high quality public education cannot be determined as it depends on the choices and analyses of the State Board. The amendment specifies that the educational components of a high quality education include those necessary to provide this education to public preschool students

¹ The Local Government Fund (LGF), the Local Government Revenue Assistance Fund (LGAF), and the Library and Local Government Support Fund (LLGSF).

² Section (D) of the amendment.

as well as students in grades kindergarten through twelve.³ Funding for public preschool students is not currently included in the school funding formula. The fiscal implications of including public preschool students in this finding is unknown at this time.

The amendment provides for a two-year transitional period (FY 2009 and FY 2010). During the transitional period, the amendment stipulates that the "annual per pupil state funding level for all Public School Pupils" be increased each year by both "inflationary increases representing increases in the cost of living" and five percent.⁴ This analysis assumes that the "annual per pupil state funding level for all Public School Pupils" refers to the base cost formula amount per pupil. If the consumer price index (CPI, 2.2% in FY 2007) is used as the measure of inflationary increases in the cost of living, the base cost formula amount would have increased by 7.2% from FY 2006 to FY 2007 (5.0% plus 2.2%), resulting in a base cost formula amount of \$5,663 per pupil in FY 2007. The actual increase in the base cost formula amount was 2.3%, resulting in a base cost formula amount of \$5,403 per pupil. Thus, under the amendment, the base cost formula amount would have been \$260 more per pupil if FY 2007 was the first year of the transitional period. If no other changes are made to the funding formula, an increase of \$260 in the base cost formula amount per pupil would have increased state basic and categorical aid by approximately \$468.0 million. The current formula, however, has a number of guarantees that result in districts receiving more state aid than is calculated by the basic and categorical aid formulas. The actual increase in total state aid in FY 2007 would have been approximately \$227.4 million.

Required local contribution

The amendment stipulates that the "required local contribution" to the total cost of a high quality public education be limited to 20.0 mills per district.⁵ Under current law, the local share is equal to 23.0 mills for the base cost and up to 3.3 mills for the categorical costs. In FY 2007, if 20.0 mills were required as the local share for both base and categorical costs, the local share would have decreased by approximately \$1,354.3 million (excluding guarantees, which total about \$429.9 million in FY 2007). The combination of the lower local share and the higher base cost formula amount, given the guarantees in the formula, would have resulted in an increase in state aid of approximately \$1,433.8 million.

³ See the definition of "Educational Components" in section (A) of the amendment.

⁴ Division (1) of section (K) of the amendment.

⁵ Division (2) of section (E) of the amendment.

The amendment also stipulates that the required local contribution of 20.0 mills be exempt from H.B. 920 tax reductions. It essentially provides every school district with 20.0 mills that will grow with inflation. Currently, school districts have on average 4-6 inside mills that grow with inflation except for districts at the H.B. 920 20-mill floor (H.B. 920 does not allow a school district's current expense tax rate to fall below 20.0 mills.) For districts that are at the H.B. 920 20-mill floor, they already have 20.0 mills that grow with inflation. In TY 2005, 346 school districts are at the H.B. 920 20-mill floor on at least one class of their real property. About 38.4% of public school students reside in these districts.

"Public School District Local Revenue Contribution taxes"

The amendment stipulates that the initial implementation of the cost of a high quality public education and the 20-mill local contribution be no later than July 1 of the third fiscal year following the fiscal year in which the amendment is adopted.⁶ Assuming the amendment is adopted in FY 2008, FY 2011 appears to be the first year in which both the cost of a high quality public education and the 20-mill local contribution will be implemented. However, the amendment also stipulates that beginning in the third fiscal year following the adoption of this amendment (FY 2011), "required Public School District Local Revenue Contribution taxes" be no less than 20.0 equivalent mills and no more than 34.0 equivalent mills. The amendment then requires that any equivalent mills above 20.0 be reduced in six equal annual increments for each district starting in FY 2012 until all districts reach a uniform 20.0 equivalent mills by FY 2017.⁷

It is unclear whether the "required Public School District Local Revenue Contribution taxes" are the same as the required local contributions to the cost of a high quality public education. This would seem to contradict the requirement that the 20-mill local contribution be implemented by the beginning of FY 2011. If the intent of the amendment is to phase-in the 20-mill contribution from FY 2011 to FY 2017, then districts would have different local contribution rates during the phase-in period. These local contribution rates would range from 34.0 mills to 20.0 mills in FY 2011 and then be gradually phased-down until they all reach a uniform 20.0 mills in FY 2017. This is in comparison to the local share under current law (a uniform 23.0 mills for the base cost and up to 3.3 mills for categorical costs). In TY 2005, 442 of the 613 school districts (72.1%) had equivalent millage above the current maximum local share of 26.3 mills (23.0 mills plus 3.3 mills). These districts would experience higher local shares of the cost of a high quality public education than their local shares under current law. Over the six years from FY 2011 through FY 2017 these local shares would gradually decrease. The amendment includes a provision that guarantees districts receive at least as much

⁶ Division (1) of section (K), which refers to the implementation of both sections (D) and (E).

⁷ Division (3) of section (K) of the amendment.

state funding as they receive in FY 2008 or FY 2010, whichever is greater.⁸ Presumably, unless the cost of a high quality education is determined to be much higher in FY 2011 than the cost during the transition period, many districts will be on the guarantee from FY 2011 to FY 2016.

For example, if the local share in FY 2007 had been changed to be equal to between 20.0 and 34.0 mills depending on each district's current equivalent millage rate as compared to the current 23.0 to 26.3 mills, the local share statewide would have increased by approximately \$1,034.1 million. If these variable charge-off rates had been in effect in FY 2007 at the current base cost amount of \$5,403, the guarantee (based on FY 2006 state aid) cost would have been approximately \$1,472.2 million for 515 school districts and total state aid would have been approximately \$14.6 million lower. If the base cost formula amount had been increased to \$5,663, the guarantee cost would have been approximately \$1,112.0 million for 431 districts and total state aid would have been approximately \$75.9 million higher than current law. The per pupil base cost formula amount would need to be raised by another \$612 to approximately \$6,275 in order to reduce the guarantee cost to a cost similar to that under current law (\$429.9 million). This would have resulted in an increase in state aid of approximately \$511.4 million. From FY 2012 to FY 2017, charge-off rates would gradually fall, the state share would increase, and more and more districts would get off the guarantee, until all districts would have the uniform charge-off rate of 20.0 mills in FY 2017.

It is also unclear whether the phase-down of the "required Public School District Local Revenue Contribution taxes" applies to school district tax levies themselves or just to school district local revenue contributions. The amendment states that districts "may continue to levy those taxes approved prior to the effective date of this Amendment," but then it requires the phase-down of "required Public School District Local Revenue Contribution taxes" as described above.⁹ If the intent of the amendment is to phase-down school district property tax levies from FY 2011 to FY 2017 until they reach 20.0 mills, then most districts will experience a decrease in local revenues. In TY 2005, 606 of the 613 districts have equivalent millage rates above 20.0 mills. Bringing these districts' equivalent millage rates down to 20.0 mills in TY 2005 would have reduced local school district revenues statewide by approximately \$3,304.9 million. The amendment phases in this reduction. Each district must have an equivalent operating tax rate between 20.0 and 34.0 mills in FY 2011. Over the six years from FY 2011 through FY 2017 local revenues would decrease for each district in six equal increments until each district's equivalent millage rate is 20.0 mills. In FY 2011, local revenues would be reduced by

⁸ Division (2) of section (K) of the amendment.

⁹ Division (3) of section (K) of the amendment.

approximately \$549.7 million, then would further be reduced by \$459.2 million in each of the succeeding six years.

If this interpretation is correct, the amendment seems to differentiate between two types of local taxes: those used for the local revenue contribution to the State Board-defined "high quality education" and those used for additional opportunities. The amendment phases down each district's local revenue contribution taxes so that they are collecting 20.0 equivalent mills by FY 2017. The amendment requires the General Assembly to make provision for voted tax levies to provide additional educational opportunities.¹⁰ Presumably, unless the state were to reimburse districts for these local tax losses either directly or through funding a much higher cost education, districts would need to seek voter approval of these additional tax levies in order to offset reductions in local revenues from local revenue contribution taxes.

If, on the other hand, the intent is just to phase down school district local revenue contributions and not school district taxes, the effect on district revenues is much different. As explained previously, many districts will be required to make greater contributions to the formula as compared to current law, from FY 2011 to FY 2016, until the charge-off is reduced to a uniform 20.0 mills beginning in FY 2017. If district taxes are not reduced, however, all the taxes above the required local contribution will be available for additional opportunities that are above the State Board-defined "high quality education."

Property tax value exemption

The amendment provides a new exemption in property tax value for owner-occupied residences owned by persons age 65 or older or persons who are totally and permanently disabled. The first \$40,000 of market value is exempted from districts' "required Local Revenue Contribution taxes" for these residences. At the current 35% assessment rate for real property,¹¹ \$40,000 of market value is equal to \$14,000 of assessed value. According to the 2000 Census, 777,392 owner-occupied housing units in Ohio had a householder 65 years of age or older. Assuming an additional 32,000 to 33,000 householders would qualify for the exemption due to a disability, approximately 810,000 householders would qualify. The value of property exempted under this provision may be roughly estimated as approximately \$11.3 billion in TY 2005.

¹⁰ Section (H) of the amendment.

¹¹ Division (2) of section (E) of the amendment prohibits the General Assembly from increasing the assessment rate for residential real property above 35%.

This exemption will reduce annual local revenue by approximately \$283.5 million assuming a uniform 20-mill local revenue contribution for school districts and 0.5 mills for joint vocational school districts. If the required local revenue contribution remains at 23.0 to 26.3 mills for FY 2008 and FY 2009 and then there were to be variable rates (higher than 20.0 mills for many districts) from FY 2011 to FY 2016, as described earlier, local revenue losses during these eight years will be higher. Since the required local revenue contribution rate is to be equal to the property tax exemption rate in each year, the state will be required to pay for districts' revenue losses through state education aid as districts' local contributions will decrease. It is unclear how this program will interact with the current homestead exemption program. This analysis assumes a person will receive exemptions from both programs if he or she is eligible for both programs.

School facilities

The amendment requires the General Assembly to continue to provide funding for school facilities as under current law through FY 2012.¹² However, the amendment also requires that the General Assembly ensure, effective January 1, 2012, school facilities necessary to a high quality education defined by the State Board and permits school districts to levy "taxes to provide a reasonable local contribution to the cost" of these facilities "not to exceed five equivalent mills."¹³ It is unclear if the intent is that the facilities program be completed (all districts have the school facilities necessary for a high quality education) by January 1, 2012, in which case the state may need to accelerate the current school facilities program in order to reach that goal. Alternatively, perhaps the intent is that the current program continue on its current schedule and that a new program with a different assessment of school district facility requirements begin in 2012. Furthermore, it is unclear whether the five-mill cap on the local contribution only apply to projects started in 2012 or later, or whether it also applies to projects started under the current program. In comparison with current law, placing a five-mill cap on the local contribution will likely increase the state share of the school facilities program.

Public higher education and local governments

The amendment requires that state funding for higher education increase each year by *at least* the percentage increase in Ohio personal income. It also requires that state funding for local governments increase each year by the same percentage increase in Ohio personal income.¹⁴ This analysis assumes that the state contributions to local

¹² Division (4) of section (K) of the amendment.

¹³ Division (4) of section (D) of the amendment.

¹⁴ Sections (G) and (I) of the amendment.

governments on which this increase is based includes funds currently distributed through the Local Government Fund (LGF), the Local Government Revenue Assistance Fund (LGAF), and the Library and Local Government Support Fund (LLGSF). The effects of this provision will accumulate over time. The following table shows the long-term effect of this provision had it been adopted in FY 1997. As can be seen from the table, the actual percentage change in these two funding categories has been at times higher than the percentage change in Ohio personal income, especially for local government funding. This analysis assumes that in those years, under the amendment, the percentage increase in funding would have been no more than the percentage change in Ohio personal income.

Fiscal Year	% Change in OH Personal Income	Actual % Change in Higher Education Funding	Difference in Higher Education Funding	Actual % Change in Local Government Funding	Difference in Local Government Funding
1st	5.4%	4.0%	\$26.9 million	6.2%	-\$7.4 million
2nd	6.0%	6.0%	\$27.6 million	10.0%	-\$49.3 million
3rd	4.7%	4.2%	\$42.0 million	6.8%	-\$75.1 million
4th	4.6%	5.7%	\$17.5 million	5.5%	-\$89.6 million
5th	3.3%	3.5%	\$11.5 million	4.9%	-\$112.7 million
6th	1.6%	-2.5%	\$115.2 million	-1.8%	-\$68.7 million
7th	2.4%	-1.9%	\$221.7 million	-3.9%	\$11.5 million
8th	2.6%	0.0%	\$290.4 million	-6.9%	\$129.8 million
9th	4.1%	1.3%	\$369.1 million	5.7%	\$115.9 million
10th	4.2%	0.8%	\$468.1 million	0.2%	\$170.6 million
11th	5.3%	3.5%	\$538.5 million	-1.1%	\$259.0 million

The table shows the cumulative effect of the provision, rising for higher education from an increase of \$26.9 million in FY 1997 to an increase of \$538.5 million ten years later; and rising for local governments from a decrease of \$7.4 million in FY 1997 to an increase of \$259.0 million ten years later. The first-year effect of the provision if it had been adopted in FY 2007, would have been an increase of \$45.4 million for higher education and an increase of \$79.3 million for local governments. Currently, Ohio personal income is projected to increase at rates of 4.5% in FY 2008, 5.1% in FY 2009, and 5.2% in FY 2010.

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If you have any questions about this information, please contact me at 466-6274.

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