Attachment A

Colorado
Legislative
Council
Staff

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MEMORANDUM

September 28, 2009

TO: School Finance Interim Committee Members

FROM: Todd Herreid, Chief Fiscal Officer, (303) 866-2633

SUBJECT: School Finance Impacts

The funding of public education in Colorado is affected by numerous constitutional and statutory provisions. In particular, three constitutional provisions affect public school funding in different and sometimes conflicting ways. The following memo provides a brief overview of how those provisions affect public school funding requirements. The first section briefly explains sources of revenue for school finance. The second section examines the impact of the Gallagher Amendment on public school funding. The third section describes the TABOR amendment and its impact on school funding. The final section examines Amendment 23. The memo also describes the interaction of certain statutory requirements for school finance within the relevant sections.

K-12 Public School Funding. Kindergarten through twelfth grade public education in Colorado is financed from state and local sources of revenue. The state sources come from the General Fund, the State Education Fund, and the State Public School Fund, with the majority of the money coming from state income and sales taxes. The local portion is derived from property taxes and specific ownership taxes on motor vehicles. Under Colorado's school finance act, state funding makes up the difference between total funding, which is formula driven, and the amount available from local sources. The share of public education revenue from state sources has grown from 44 percent to 65 percent in the last twenty-three years. The local share has correspondingly dropped from 56 percent to 35 percent in the same time period.

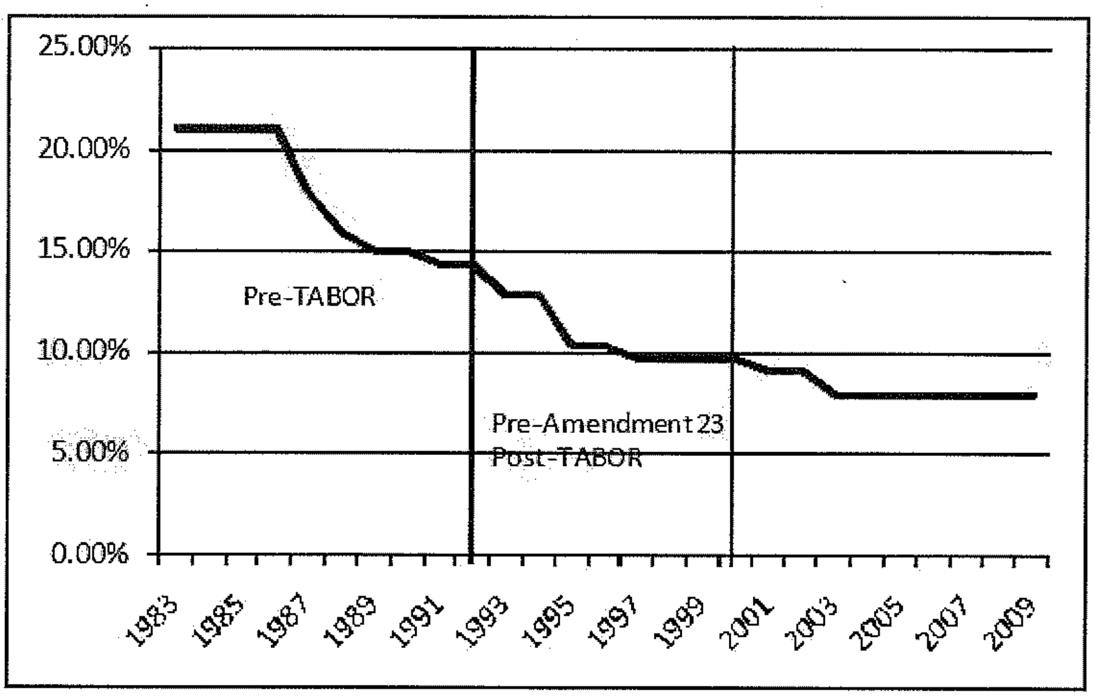
Impact of the Gallagher Amendment on school finance. The Gallagher Amendment to the state constitution was adopted by the voters in 1982. The amendment required that the residential assessment rate, which is used to determine the taxable value of residential property, be adjusted every two years (in odd years) to maintain a proportional relationship between the assessed value of residential and nonresidential property. This has typically been referred to as the 45-55 split, in which 45 percent of statewide assessed value is residential and 55 percent is nonresidential. The mechanics of the Gallagher Amendment generally resulted in the following changes to the residential assessment rate:

- The residential assessment rate would ***fall*** if the actual value (or market value) of residential property grew faster than nonresidential property statewide or the actual value of residential property fell more slowly than nonresidential property statewide. The rate would also fall if the actual value of residential property rose, while the value of nonresidential property fell.

- The residential assessment rate would ***rise*** if the actual value (or market value) of residential property grew more slowly than nonresidential property or the actual value of residential property fell more rapidly than nonresidential property. The rate would also rise if the actual value of nonresidential property rose, while the value of residential property fell.

The residential assessment rate has declined fairly steadily over time, falling from 21.00 percent in 1983 to 7.96 percent in 2003. This occurred because the actual value of residential property grew faster than nonresidential property. Since 2003, the residential assessment rate has not changed, although it would have increased in the absence of the TABOR Amendment. This issue is examined in the third section of the memo. Figure 1 shows the change in the residential assessment rate since 1982.

Figure 1
Residential Assessment Rates



Under the Gallagher Amendment, if the residential assessment rate were to decrease, the local share of school funding would drop, while the state's share would rise, compared with the alternative of no change in the residential assessment rate. However, prior to the TABOR Amendment, the General Assembly was able to set the state and local contributions for school finance and adjust mill levies accordingly. Following the passage of TABOR, the residential assessment rate was prevented from rising even when it may have been required under the Gallagher Amendment. This would have increased the local share of school funding and lowered the state's share. In the most recent reassessment cycle, the residential assessment rate should have increased from 7.96 percent to 8.85 percent, but passage of the TABOR amendment requires a statewide vote for any increase in the residential assessment rate.

Impact of the TABOR amendment on school finance. The TABOR amendment was approved by the voters in 1992 and contains several provisions that affect funding for state and local governments, including school districts. The following are the most pertinent elements:

- it sets specific limits on the amount of revenue that can be collected and retained by the state and local governments. In general, this limit is equal to the lesser of actual revenue or the prior year's amount increased by inflation plus a growth factor, such as population growth;

- it imposes a limit on local property taxes equal to inflation in the prior calendar year plus a local growth factor, such as student enrollment growth; and

- it requires voter approval for an increase in a district's mill levy or an increase in the assessment rate for any class of property, including residential property.

TABOR directly affects public school funding by limiting the amount of revenue that a school district can retain and spend. Districts that exceed this limit must refund the excess revenue to local taxpayers, unless they receive voter approval to keep the excess. Because state aid is counted as TABOR revenue for a school district and this revenue has typically grown much faster than inflation plus enrollment growth, most school districts have received voter approval to retain the excess revenue.

It should also be noted that while school districts have received approval to keep surplus revenue, the School Finance Act of 1994 retained the TABOR provision that school district property taxes can only increase by inflation plus student enrollment growth. When property taxes exceed this limit, school district mill levies are required to fall. This provision was eliminated, however, in Senate Bill 07-199, which had the effect of preventing mill levies from falling below FY 2006-07 levels for most districts.[1] Figure 2 shows the savings the state received as a result of the bill. This also serves as an estimate of the impact of the TABOR provision limiting local property taxes for school districts. For instance, in FY 2007-08, state aid for school finance was reduced by $117.8 million because the local contribution from property taxes was $117.8 million higher.

In addition, TABOR prevented the residential assessment rate from rising in the last two reassessment cycles, as would have been required under the Gallagher amendment.

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[1]For some school districts, SB07-199 lowered district operating mill levies to 27 mills.

This would have caused state aid to be lower because the local contribution to school funding would have been higher.

Figure 2
Estimated School Finance Impact of Mill Levy Changes in SB07-199

Fiscal Year	Net Impact	Levy Freeze Only*
	Annual	Annual
FY 07-08 (actual)	$117.8	$123.2
FY 08-09 (actual)	$129.5	$134.5
FY 09-10 (projected)	$150.7	$155.7
FY 10-11 (projected)	$155.4	$160.3
FY 11-12 (projected)	$232.5	$236.1
FY 12-13 (projected)	$246.6	$250.3

*Excludes impact from school districts where mill levies were decreased to 27 mills.

Impact of Amendment 23 on school finance. Amendment 23 was approved by the voters in 2000 and established minimum increases in "base" per pupil funding for kindergarten through twelfth grade public education as well as categorical programs, such as special education and vocational education. As a result, the General Assembly's budget flexibility was reduced. The amendment made four major changes:

- it required that the statewide "base" in the school finance act be increased by at least inflation plus one percent for ten years - through FY 2010-11 - and at the rate of inflation thereafter;

- it required that total funding for all categorical programs be increased by at least inflation plus one percent for ten years and at the rate of inflation thereafter;

- it created the State Education Fund and transferred to the fund an amount equivalent to one-third of one percent of federal taxable income from the General Fund. This revenue is exempt from TABOR limitations; and

- for the ten years through FY 2010-11, it required the state's General Fund contribution to the school finance act to be increased by a minimum of five percent annually if personal income grows by at least 4.5 percent. This is known as the maintenance of effort provision.

Prior to SB07-199, Amendment 23 affected state funding for public schools by requiring increases in the school finance act that exceeded the maximum allowable increase in property taxes through FY 2010-11 by one percentage point. In addition, this gap grew to the degree that property taxes were below the limit. Following SB07-199, Amendment

23 will create budget pressures to the degree that assessed values grow more slowly than total school funding.

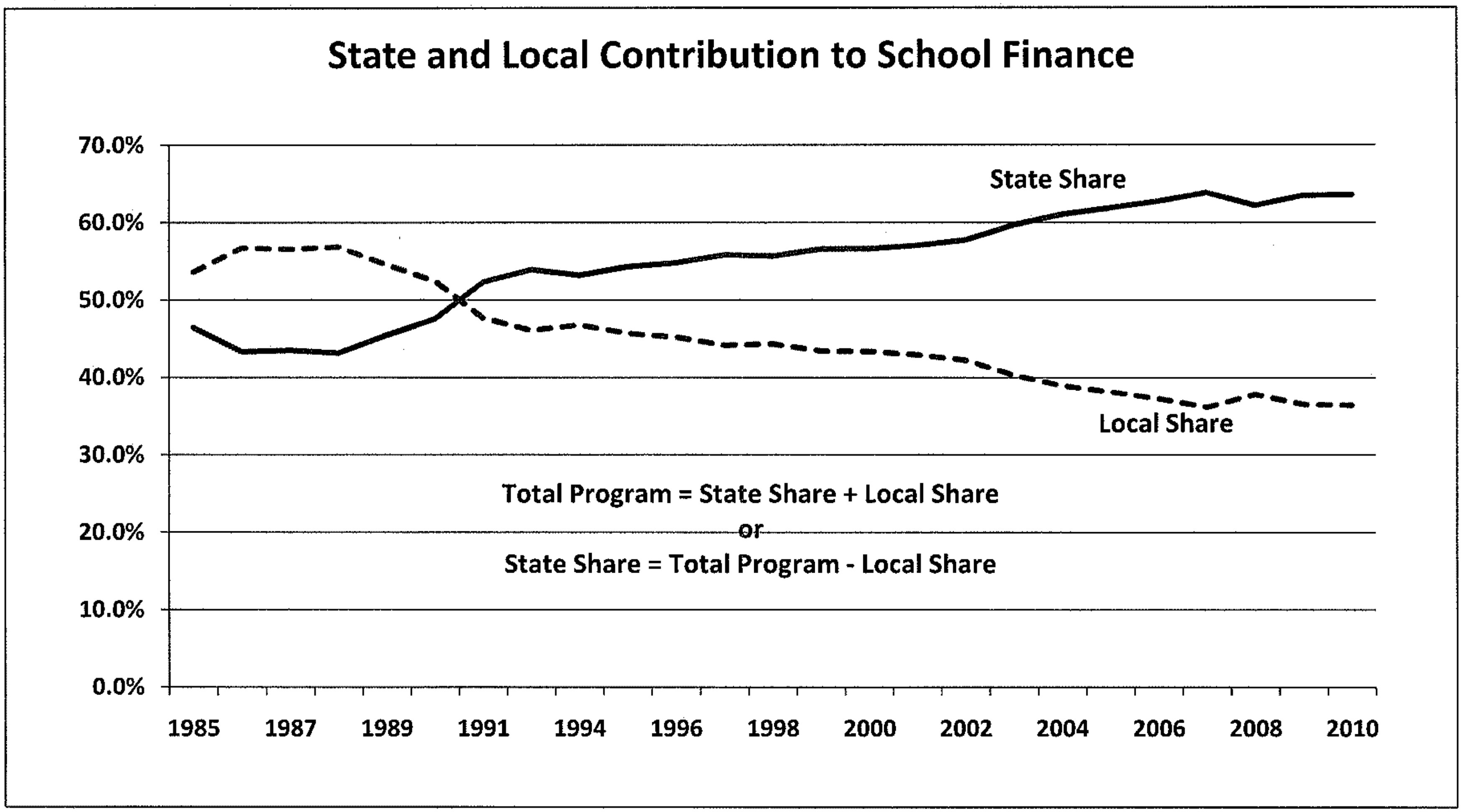
Although it is impossible to know how much school funding would have been in the absence of Amendment 23, Figure 3 shows the estimated change in school district funding from the one percentage point requirement and the increase in categorical program funding from the inflation plus one percentage point requirement. In FY 2009-10, the one percentage point requirement added approximately $493.6 million to school funding, and the inflation plus one percent requirement added $88 million to categorical program funding.

Amendment 23 also created budget pressure by transferring one-third of one percent of federal taxable income to the State Education Fund. This transfer was expected to be paid from TABOR refunds, but the subsequent economic downturn eliminated TABOR refunds. So, from FY 2001-02 to FY 2004-05, the diversion to the State Education Fund came at the expense of the General Fund. Since revenue was below the allowable TABOR limit, a ratchet-down in the state's revenue limit occurred. Consequently, during this period of time, the state did not receive the new money that was expected to pay for the requirements of Amendment 23.

However, passage of Referendum C in 2005 eliminated the ratchet-down effect and permitted the state to retain and spend all excess revenue in the period from FY 2005-06 to FY 2009-10 and up to a capped amount each year thereafter beginning in FY 2010-11. The Referendum C cap, which is based on the year in which the state collects the highest amount of revenue between FY 2005-06 and FY 2009-10, will not ratchet-down during the current recession or in future recessions. Therefore, in any year in the future in which a TABOR refund would have otherwise existed, the transfer of money to the State Education Fund will not create additional budget pressures for the state.

Figure 3
Estimated Funding Increase from Amendment 23 (millions of dollars)

Fiscal Year	School Finance	Categorical Funding	Total
2001-02	$36.5	$7.1	$43.6
2002-03	$78.2	$15.6	$93.8
2003-04	$121.9	$20.2	$142.1
2004-05	$167.8	$23.6	$191.4
2005-06	$216.5	$25.4	$241.9
2006-07	$271.1	$55.2	$326.3
2007-08	$339.4	$68.3	$407.7
2008-09	$412.4	$75.1	$487.5
2009-10	$493.6	$88.0	$581.6
TOTAL	**$2,137.4**	**$378.5**	**$2,515.9**


State and Local Contribution to School Finance
70.0%
60.0%
50.0%
40.0%
30.0%
20.0%
10.0%
0.0%
1985
1987
1989
1991
1994
1996
1998
2000
2002
2004
2006
2008
2010
State Share
Local Share
Total Program = State Share + Local Share
or
State Share = Total Program - Local Share