Financing Public Education in Texas
Kindergarten through Grade 12
Legislative Primer

Second Edition

Prepared by Legislative Budget Board Staff

November 2000

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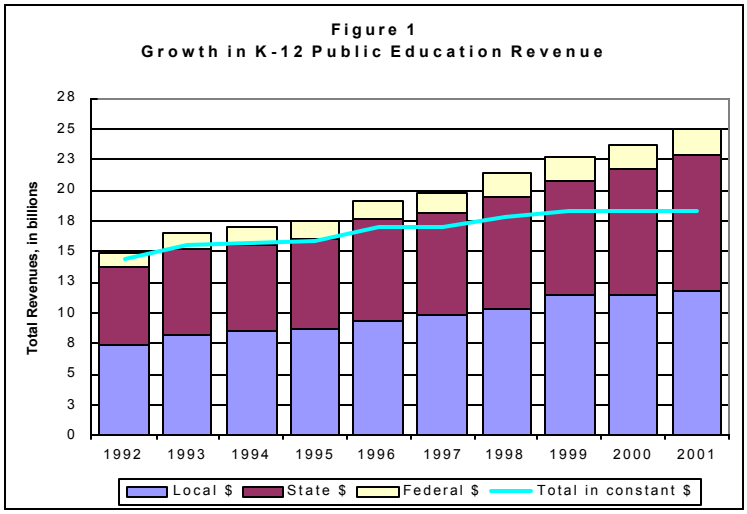
Introduction

This report is an overview of public school finance in Texas. It is intended to serve as a guide to the mechanics of the current funding laws. Appendices include an "Overview of Litigation and Legislative Responses, and Equity Measures,""Frequently Asked Questions," and a "Glossary."

Funding public education in Texas is primarily a responsibility of the state and local school districts. For the 2000-01 biennium, state taxes are estimated to generate approximately 44 percent of the total funds and local school district property taxes 47.5 percent of the total. The federal government provides approximately 8.5 percent of the revenue, most of it earmarked for specific federal education programs.

The state's school funding contribution is, in part, driven by efforts to maintain certain standards of equity within the school finance system. These equity standards are a result of nearly 20 years of litigation. (see Appendix A for a more detailed discussion of litigation and equity issues)



Total state and local K-12 public education costs are estimated at $44.6 billion in the current biennium, representing the single largest funding priority in the state and local budgets. This figure has increased from $28.9 billion in the 1992-93 biennium.

There are four fundamental factors that influence the state's public education budget and its growth:

- Local Tax Base (local property values);
- Local Tax Rates;
- Student Enrollment; and
- Student and District Characteristics.

The interactions of each of these factors is described in this report.

Mechanics of Current School Finance Laws

OVERVIEW

The basic structure of K-12 public education financing in Texas is a three-tiered system that ensures a school district access to revenue based on the district's tax effort. It preserves a balance between state and local funding responsibility and local autonomy. State aid is provided to school districts in inverse proportion to district wealth in order to ensure a high degree of revenue equity.

The three tiers of the system are:

- Tier 1 ensures a base funding level for all students at a local tax rate of $0.86 per $100 of property value. All districts are entitled to $2,537 per student in Average Daily Attendance (ADA). This entitlement is increased according to certain district and student "adjustments" (or "weights") that apply to the district and the individual students in the district. If the district cannot generate its entitlement with local revenue, state assistance will make up the difference.

- Tier 2 has been referred to as the "enrichment" tier. It delivers state aid to districts based on a district-selected tax rate between $0.86 and $1.50. The mechanism that ensures a high level of equity in the system is the "guaranteed yield," which is a state guarantee of a specific revenue yield per "weighted" student (WADA) per penny of local tax effort, regardless of local property wealth. The guaranteed yield is $24.70 per weighted student per penny of tax effort in Tier 2. If a district's wealth level generates less than $24.70 per WADA, state assistance will make up the difference.

- Tier 3 consists of two state programs that provide financial assistance to districts for debt associated with school facilities. The Instructional Facilities Allotment (IFA), established in 1997, guarantees a specific revenue yield per student per penny of local tax effort for new instructional facilities. Districts that have received voter approval to sell bonds for instructional facilities can apply for assistance through the IFA program. In 1999, the Legislature added the Existing Debt Allotment (EDA) to Tier 3. With the EDA, state assistance is provided through a guaranteed yield system for a certain number of pennies of tax effort related to the repayment of existing school district bonds. To be eligible, the tax rate associated with the bond issuance had to be levied in the 1998-99 school year. The yield for both of these programs is $35 per student (not "weighted") per penny of tax effort in Tier 3.

The Equalized Wealth Level (referenced in Chapter 41 of the Texas Education Code) is not a "tier" to deliver state funds to school districts. Instead, it serves as a limit on the revenue-generating capacity of wealthy districts. Any district with per weighted pupil property wealth exceeding $295,000 is required to reduce its wealth. (Because of "hold-harmless" provisions, some school districts have retained access to wealth greater than $295,000 per weighted pupil.) The two most common methods selected

by school districts to reduce their wealth are to share revenue with other school districts and to share revenue with the state (which redistributes the funds through the Foundation School Program). This revenue sharing is also known as "recapture." As of 1997, the revenue generated by tax effort associated with debt service is not subject to recapture.

Figures 2, 3, and 4 illustrate the mix of state and local revenue in the three tiers based on the wealth level of the school district. The wealth level of each district is based on WADA:

Figure 2
District at $150,000 Wealth Level

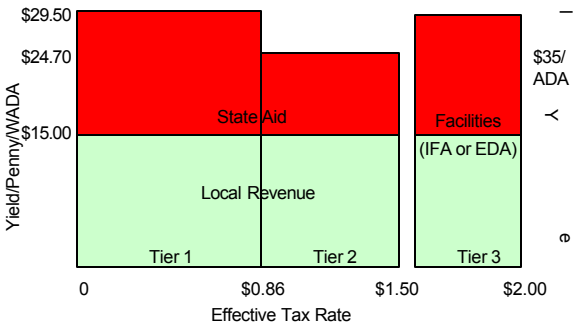


Figure 3
District at $270,000 Wealth Level

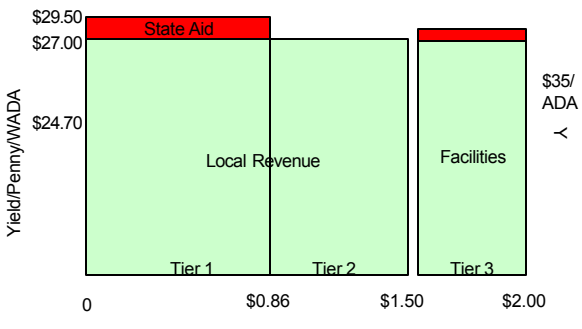


Figure 4
District at $350,000 Wealth Level

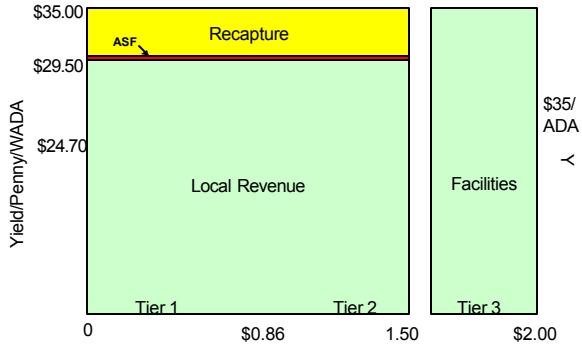
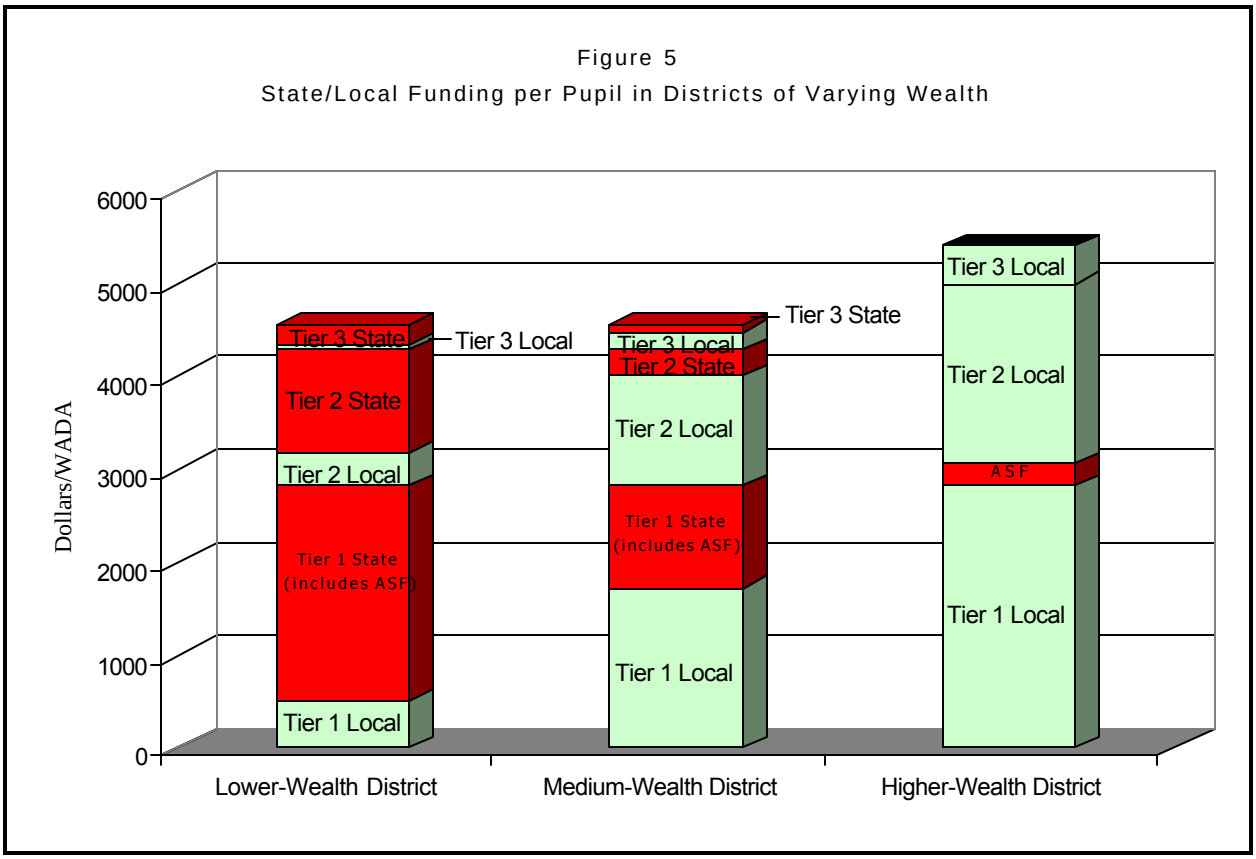


Figure 5 illustrates the difference in per student funding levels in school districts with varying property wealth levels (Note: The wealth levels in Figure 5 are different from those depicted in Figures 2, 3 and 4.), but similar levels of tax effort. The disparities in revenue among districts have declined significantly over the past 20 years, but revenues are not completely divorced from district wealth.



The next two sections of this report present the mechanics of how revenue is generated within the Texas school finance system by dividing the system into two primary sections: Local Revenue and State Funding. The last section is a short summary of federal funds dedicated to public education.

LOCAL REVENUE

Of the $44.6 billion in state and local revenue for public schools in the 2000-01 biennium, it is projected that fifty-two percent will be generated from local district revenue. While 95 percent of local revenue is generated from the local property tax, a minimal amount of local revenue is generated from interest earnings, revenue from co-curricular activities, tuition, and fees.

Revenue from the property tax is the product of a basic calculation:

Local Revenue = [local property tax base] x [locally determined tax rate]

Tax Base and Appraisals

The tax base is defined as the value of all taxable property within a jurisdiction. "Taxable property" in Texas consists of residential and business properties. Residential property is comprised of "real" property, which includes land, its inherent natural resources, and any improvements thereon. Business property consists of real property plus capital assets, inventories (except in certain cases), and defined intangible goods, such as stocks, bonds, and mortgages.

The property tax base in Texas soared during the mid 1980s and decreased 7 percent in nominal dollars between 1989 and 1994. It has increased since 1995.

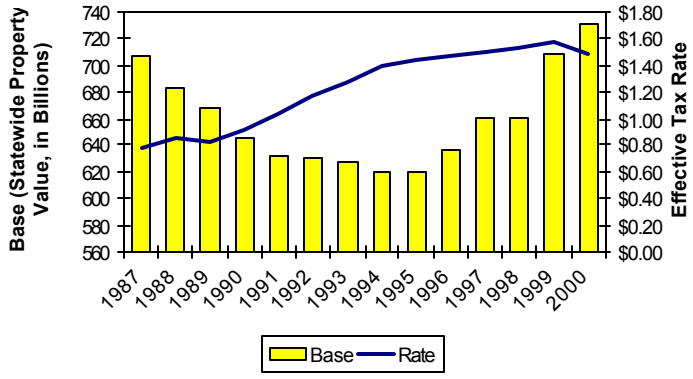
Property value appraisals are executed by county appraisal districts. The Texas Comptroller of Public Accounts conducts a statewide property value study to determine the validity and uniformity of local appraisals.

There are 1,035 school districts in the state. The tax base among these districts varies considerably. Kenedy County Wide ISD has more than $3 million in property wealth per student in enrolled student, while Boles ISD has less than $10,000 in property wealth per enrolled student. In general, the wealthiest districts in the state derive most of their wealth from commercial property. The Glen Rose ISD, for example, generates 95 percent of its property value from utility industry property. Excluding commercial property, the wealthiest district in the state is the Highland Park ISD in Dallas County. Nearly 80 percent of its property value is generated from residential property.

Tax Rate

The local school board sets a property tax rate according to the proposed budget of the respective school district. Once a school district's budget is prepared, the board president must call a board meeting to adopt the budget. Notice of the public meeting to adopt a budget and proposed tax rate must appear in the newspaper no later than 10 days nor earlier than 30 days before the date of the meeting.

Figure 6
Statewide Property Tax Base and Rate



The budget must be adopted before the tax rate (Education Code §44.04(g)). The tax rate must be adopted before the later of September 30 or the 60th day after the district received the certified appraisal roll (Tax Code §26.05(a)). If the tax rate is not adopted in time, the rate will be the lower of the effective tax rate for that year or the tax rate for the preceding year.

After adjusting the tax rate for a "rollback election" (see page 11), the rate is applied to the value of the district's property tax base as of January 1 of that year. Tax bills are delivered in October and are due by the following January 31.

Nominal vs. Effective Tax Rates

The tax rate on a property tax bill is the "nominal" tax rate. State funding formulas rely on an "effective" rate, which differs from the nominal rate. The effective rate is calculated by dividing a district's prior year property value into its total property tax receipts, or "collections" (this is a variation of the *local property tax base* x *locally determined tax rate = revenue* formula).[1] Districts receive state assistance according to how much local revenue they actually collect (including delinquent revenue but excluding

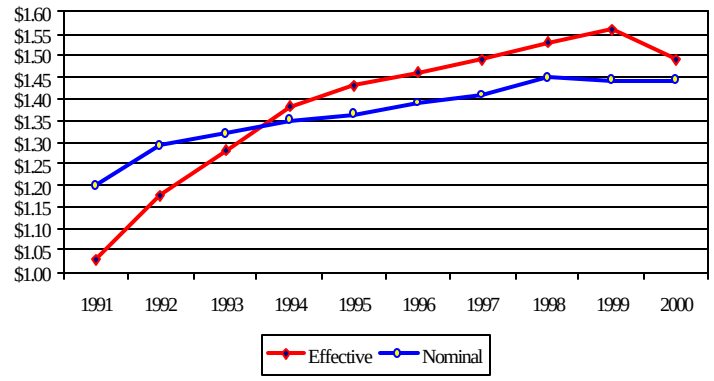
[1] As an example, the state funding formulas in FY 2000 (which roughly corresponds with the 1999-2000 school year) use calendar year 1999 collections divided by 1998 district property values.

local exemptions and abatements), rather than how much they levy. The *levy* is simply the amount billed. The differences between the two rates are summarized as follows:

Nominal (used by districts) Tax Rates	Effective (used by the state) Tax Rates
Definition: Rate = Local Levy (total billed) / **Current yr.** District Property Value	Definition: Rate = Local Collections (revenue) / **Prior yr.** District Property Value
C Honors state and local exemptions C Honors abatements C Based on locally determined property values and set according to local budget needs.	C Honors state but not local exemptions C Does not honor abatements after May, 1993 C Based on Comptroller-certified property values of the prior year.

The last distinction between the property tax year on which the rates are based, creates a "lag" between the local property valuation and the district's receipt of state funds. Using prior year values may result in districts receiving less or more from the state than current property values would generate (the effective rate may be higher or lower than the nominal rate). This is especially pronounced in districts experiencing rapid growth or declines in population and property values.

Figure 7
Comparison of Effective & Nominal Tax Rates



In recent years, increasing property values in some districts have produced effective rates that are higher than nominal rates (see Figure 7). Since state aid is based on the effective rate, this has benefitted these districts.

Districts with declining property values have had the opposite experience. Effective rates based on prior year values tend to understate the district's actual tax rate and they receive less state aid in the current year than they otherwise would. To offset the revenue loss in districts with rapidly declining property values, the Education Code (§42.2521) grants the Commissioner of Education the discretion to award additional state funds in the current year to such districts.[2] In recent years, this relief has been directed primarily to a number of districts in West Texas which have lost mineral wealth.

[2] Rider 10 of the 2000-01 General Appropriations Act allocates $133 million to provide for school district losses due to property value declines and authorizes the TEA Commissioner to distribute an additional $26 million if necessary.

While this use of prior year property values has a great influence on the difference between the nominal and effective tax rate, the issue of property tax exemptions also has an effect.

The state "recognizes" the following exemptions: $15,000 homestead exemption; $10,000 school district elderly and disabled homestead exemption; school tax ceiling for elderly, which caps taxes on homesteads by freezing the tax payment of a homeowner at age 65; the disabled veteran exemption, which exempts from $5,000 to $12,000 on property owned by a disabled veteran or surviving spouse; and the Freeport exemption (for certain tangible personal property that remains in Texas no more than 175 days). By recognizing these exemptions, the state assumes a school district does not have access to this property value for tax purposes.

The state does not "recognize" the following exemptions: optional percentage residence homestead exemption (up to 20 percent of the market value of a residential homestead)[3]; and optional elderly and disabled person homestead exemption, which allows an additional $3,000 exemption on homesteads of the elderly and/or disabled. Failure to recognize an exemption means the state assumes a school district has access to revenue that would have been generated from the property value that is exempted. The result would be an effective tax rate less than the nominal tax rate.

Based on a September 1999 survey by the Texas Education Agency, the average nominal tax rate for 1999-2000 was $1.45. The highest nominal tax rate was levied by Allen ISD ($1.90) and the lowest nominal tax rate was levied by Glen Rose ISD ($0.83). Based on the LBB model prepared in May 1999, the average effective tax rate for 1999-2000 was $1.49. The highest effective tax rate was levied by Hays Consolidated School District ($1.83) and four districts tied for the lowest an effective tax rate at $0.86.[4]

Tax Rate Limits

School district property tax rates in Texas have two functional components: a “maintenance and operations” (M&O) rate that funds all administrative and operational costs; and an “interest and sinking” (I&S) rate, also known as a “debt service” rate, that is used to finance debt associated with construction, renovation, and purchase of property and equipment.

[3] The Education Code (§42.2522), added by Senate Bill 4 in 1999, authorizes the Commissioner of Education, if funds are available, to fund one-half of this residence homestead exemption. The Commissioner has implemented this provision for the 2000-01 school year.

[4] The lowest nominal rates are actually lower than $0.86; state funding formulas impose a “floor” rate of $0.86.

The nominal M&O tax rate is limited by statute (TEC §45.03(d)) to $1.50 per $100 assessed valuation.[5] State assistance on M&O tax effort is limited to $0.86 in Tier 1 (TEC §42.252) and $0.64 in Tier 2 (TEC §42.303), for a maximum of $1.50.

The I&S tax rate is limited to $0.50 on all debt issued after September 1, 1992, except in special circumstances (TEC §45.003 (e)). There is no cap on the debt that was issued before this date and there have been districts with total tax rates over $2.00. Tier 3 provides a "guaranteed yield" on certain new I&S tax effort and 12 pennies (more, if funding is available) of tax effort related to existing (I&S) debt service.

Rollback Rates

Rollback elections provide voters with an opportunity to "roll back" proposed tax increases above a specified limit. So as not to harm a district's ability to pay its debt service, the rollback rate applies to maintenance and operations (M&O) tax effort. Generally speaking, rollback provisions are designed to allow school districts to set a tax rate to generate the same amount of state and local revenue per weighted average daily attendance (WADA) as they had the prior year, plus a certain number of pennies. During the 76th Legislative Session, Senate Bill 4 amended the Tax Code (§26.08(j)) to permit "a school district to adopt a tax rate that maintains the maximum level of state and local revenue per student to which it had access in 1999-2000, even if the district did not actually collect sufficient maintenance and operations taxes in that year to earn the maximum state aid."[6] For school year 1999-2000, school districts could increase the tax rate $0.03 above this tax rate.[7] For the 2000-01 school year, the $0.03 increases to $0.06. (Prior to 1999, the limit on increases for school districts was $0.08.)

If a school district sets a tax rate greater than the rollback rate, an election to adopt the rate is automatically triggered. (For other taxing units, setting a tax rate greater that the rollback rate would allow voters to petition for an election to roll back the proposed tax rate.) If a majority of the district's voters approve the tax increase, the adopted tax rate is in effect. If voters disapprove, the current tax rate takes effect.

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[5] A few school districts have locally adopted tax rate limits that have grandfathered in a higher or lower rate than the $1.50 provided in statute. State aid related to maintenance and operations for these school districts remains limited to a $1.50.

[6] September 15, 2000 letter from Commissioner of Education Jim Nelson to Texas Legislators.

[7] For the 1999-2000 school year, school districts who participate in Social Security were provided additional rollback protection. For these districts, the rollback rate was increased to allow the district to generate the same amount of revenue as the taxes paid by the district during the 1998-99 school year for Social Security payments.

Of the 11 school district rollback elections in 1999, voters "rolled back" rates in three school districts.[8] Between 1990 and 1998, there were 26 school district rollback elections. Tax rates were rolled back in 12 of these elections.[9]

[8] Comptroller of Public Accounts, Statement, "8 of 11 School Districts Succeed in 1999 Tax Rate Rollback Elections," January 2000.

[9] Comptroller of Public Accounts, "School & Appraisal Districts' Property Value Study," 1998 Final Report (1999), p. 4.

STATE FUNDING

State funding "equalizes" disparate local funding levels across districts. It is allocated in inverse proportion to local property wealth, thus narrowing the gap in per pupil spending between rich and poor districts. Districts with per pupil property wealth above a specific threshold are required to reduce their wealth.

The state formulas consist of the three "tiers" defined earlier. They constitute the Foundation School Program (FSP). The FSP was created in Texas in 1949 to provide an educational "foundation" for all students. For the 2000-01 biennium, the state appropriated $28.6 billion for the public education budget, including TEA's administrative costs. Twenty two billion of this appropriation is distributed through the FSP. There are several non-FSP programs through which a comparatively minor amount of funds are distributed.

Sources of Revenue

Of the state's $28.6 billion public education appropriation, $23.3 billion, or 81.4 percent, is General Revenue (GR) funds. General Revenue funds are supported by a multitude of taxes and fees. The largest among these is the sales tax (55 percent of GR).[10] Other significant revenue sources include the corporate franchise tax, the motor fuels tax, natural gas and oil taxes, "sin" taxes, and insurance and utility taxes.

The state appropriates GR funds and non-GR funds to public education through various categories, or "methods of finance." The separate funding categories are differentiated by source and/or application. The largest of these is the Foundation School Fund (FSF). This GR fund exists within the FSP and accounts for $18.1 billion of 2000-01 public education appropriation. FSF funds are used by school districts to pay teacher salaries, facility construction and renovation, administration, and other educational resource costs.

The Available School Fund (ASF) is also a key method of finance. For the 2000-01 biennium, the ASF amounts to $2.7 billion. It consists of interest and dividends from the Permanent School Fund (PSF)[11] and 1/4 of the collections from the motor fuels tax. A portion of the ASF monies are set aside to fund the "State Textbook Fund"

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[10] Texas Comptroller of Public Accounts, 1999 Annual Cash Reports, (1999), Austin, TX, p. 21.

[11] The Permanent School Fund (PSF), established in 1854, is an endowment consisting of land and investment holdings. PSF interest is constitutionally dedicated (Article 7, Section 5) to the Available School Fund, which must be used for public education. In fiscal year 1999, the market value of the PSF was $19.6 billion.

($704.1 million in 2000-01 biennium).[12] Of the amount in the textbook fund, $227 million is allocated for the "technology allotment." This allotment, which is used for the purchase of computers and other technology and for certain teacher training, is distributed at a rate of $30 per pupil.

Both the textbook fund and technology allotment are non-FSP expenditures. The remainder of the ASF is distributed through the FSP based on the number of students in the district. This per capita distribution varies from year to year (usually between $250 and $300) based on the income derived from the PSF. ASF allocations offset general revenue funding to school districts that receive FSP funding.

In 1997 the legislature dedicated state lottery proceeds to public education. These proceeds are considered GR funds and are expected to generate about $2.05 billion in the 2000-01 biennium.

An "Other Funds" category includes "appropriated receipts," which is primarily "recaptured" funds paid by wealthy districts ($949 million for the biennium) and moneys allocated through the Telecommunications Infrastructure Fund ($30.6 million for the biennium) for specific technology purposes.

Teacher retirement funds are not part of the FSP, but are a sizeable component of public education funding. The state appropriated $1.7 billion in GR in 2000-01 biennium to finance its public school Teacher Retirement System retiree pension ($1.44 billion) and health insurance ($0.24 billion) obligations.

Enrollment

As mentioned in the introduction to this report, student enrollment is one of the driving factors in the state's school finance system. State formulas are not actually based on "enrollment," however. The state uses the following two distinct measures of student counts in its formulas:

- ***Average Daily Attendance (ADA).*** This number is calculated by dividing the aggregate sum of each day's attendance count in the school year by the number of instructional days in the school year. LBB estimates in the General Appropriations Act indicate 3.73 million in ADA in 2000 and 3.81 million in ADA in 2001.

- ***Weighted Average Daily Attendance (WADA).*** WADA is an adjusted student count that compensates for student and district characteristics as defined by statute. Students with special educational needs, for example, are "weighted" by a factor ranging from 1.7 to 5.0 times the

[12] The state pays for 100 percent of the textbooks selected by local districts that are on the state adoption list and 70 percent of the textbooks not on the list.

"regular" program weight in order to fund their special needs. The specific weights are explained on pages 14-15. LBB estimates for the General Appropriations Act indicate 5.00 million in WADA in 2000 and 5.14 million in WADA in 2001. As these projections indicate, the statewide WADA count is about 35 percent higher than the ADA count. This ratio varies by district.

Tier 1 Basic Allotment

"Tier 1" was originally intended to provide a basic "foundation" level of funding and represents the bulk of the funds distributed through the FSP. Each school district has a Tier 1 funding entitlement based on certain district characteristics (or "adjustments") and the types of students served. School districts are required in Tier 1 to levy a local property tax rate of $0.86 (TEC §42.252(a)), but their Tier I entitlement is not based on tax effort.[13]

For districts that do not have a sufficient local tax base to generate their entitlement per pupil at a $0.86 tax rate, state funds make up the difference.[14] Districts with sufficient property wealth to generate their entitlement on their own receive only Available School Fund revenue, which is constitutionally distributed to all districts.

Each district's entitlement begins with a "basic allotment" of $2,537 per ADA in the 2000-01 biennium. The entitlement is then adjusted according to "district adjustments" if applicable. The product of these adjustments is known as the "adjusted allotment," which is uniform for all students in a district. The average adjusted allotment is $2,831.

[13] LBB funding formulas impose a floor rate of $0.86. The state and local funding shares of a district with a lower effective rate are calculated based on a rate of $0.86.

[14] In the 1999-2000 school year, for example, the state calculation of each district's local share is the Comptroller-certified 1998 property value of the district multiplied by a rate of $0.86.

The district adjustments used to establish the adjusted allotment are:

Classification	Description	Assigned Weight	2000-01 Biennium Statewide Cost ($ millions)
Cost of Education Index (CEI)	Accounts for differences in resource costs that are beyond the control of the district. The five components of this adjustment are: (a) the average beginning salary of teachers in contiguous school districts, (b) the percent of economically disadvantaged students, (c) district size (in terms of ADA), (d) location in a rural county (with a population of less than 40,000), and (e) whether the district is classified as an "independent town" or "rural." The CEI is based on a 1991 regression analysis of factors affecting variation in teacher payroll costs among school districts. It is applied to 71% of the Basic Allotment.	1.02 to 1.20	$2,126
Small & Mid-sized Adjustments	Designed to compensate for the higher fixed costs of operating schools in less populated areas. "Small" districts are classified as those with fewer than 1,600 ADA. "Mid-sized" are those with 1,600 to 5,000 ADA.	1.0 to 1.64	$854
Sparsity Adjustment	Eligibility is based on the number of students in the district, the range of grade levels available, and if high school is not available in that district, the distance to a district with a high school. Depending on these factors, the student count in a district is automatically increased to 60, 75, or 130 students for funding purposes (it does not attach a "weight" per student).		$10

The adjusted allotment is then modified by the student allotments (or weights) to determine a district's Tier 1 entitlement. The following allotments (or weights) are designed to account for the additional costs of individual student needs or attributes:

Classification	Description	Assigned Weight	2000-01 Biennium Statewide Cost ($ millions)
Special Education	There are 12 special education instructional arrangements with varying weights depending on the duration of the daily service and the location of the instruction.	1.7 to 5.0	$3,474

Classification	Description	Assigned Weight	2000-01 Biennium Statewide Cost ($ millions)
Compensatory Education	Additional funding is intended to assist students performing below grade level. Funding is based on the number of students that are eligible for a free or reduced-price lunch under the national school lunch program for a specified period. A separate component of the compensatory education program serves pregnant students.	0.2 or 2.41 if pregnant (add on)	$2,140
Career & Technology	Funds pay for materials and salaries. Funding is based on the amount of time students spend in eligible career technology courses.	1.37	$1,224
Bilingual / ESL	Additional funds are used primarily for salaries, although there are also additional resource needs. Funding is based on the number of students that elect to participate in the program.	0.1 (add on)	$233
Gifted / Talented	Additional funding pays for salaries and resources. The number of eligible students for this funding is capped at 5% of each district's ADA.	0.12 (add on)	$128

Each district also receives a "transportation allotment" in Tier 1. Transportation funds are distributed to each district based on "linear density," which is the number of students riding buses divided by the approved route miles. This formula accounts for the cost differences between transporting students in an urban and a rural district. A small portion of the state's transportation costs are distributed according to special requirements relating to a student's disabilities or other circumstances. The state provides approximately $620 million for transportation in the 2000-01 biennium, which is about half of the total transportation cost.

A recap of Tier 1 shows that:

- A school district's Tier 1 entitlement is determined by starting with the "basic allotment" and applying the district adjustments to determine the adjusted allotment. The adjusted allotment is multiplied by the student weights and the number of related students. The transportation allotment is added to this figure.

- A school district's Tier 1 state aid is determined by subtracting the district's Local Fund Assignment from the Tier 1 Entitlement. The Local Fund Assignment is established by multiplying a district's Certified Taxable Values for the preceding year by a $0.86 M&O tax rate.

Tier 2 Guaranteed Yield

"Tier 2" is a "guaranteed yield" program distributed through the Foundation School Program. As in Tier 1, the state "guarantees" revenue in Tier 2, but unlike Tier 1, districts have tax rate discretion in Tier 2. They may set a maintenance and operations (M&O) tax rate anywhere between $0.86 and $1.50 (TEC §42.303) and the state ensures that they will generate no less than $24.70 per WADA per penny of tax "effort" (effective rate), regardless of local property wealth. This mechanism does not guarantee a minimum per pupil revenue for every district; it guarantees the same minimum per pupil revenue *per tax effort* in the designated range. In this sense, it guarantees revenue while preserving local control of tax rates.

The student weights presented in Tier 1 play an important role in Tier 2, because the guaranteed yield is based on "weighted" ADA. The use of WADA results in more Tier 2 money to school districts with students in special programs and students who qualify for the federal lunch program than would have been distributed to them using ADA.

Based on changes made by Senate Bill 4 in 1999, state Tier 2 funds may not be used for debt service or capital outlay.[15] Prior to this change, school districts could use state Tier 2 funds for any purpose.

As discussed earlier, total revenue is a product of tax rate and tax base. A home valued, after recognized exemptions, at $247,000 generates $24.70 per penny of tax levied. The guaranteed yield mechanism means state assistance is provided to ensure that districts with less than $247,000 in per *pupil* property wealth are able to generate $24.70 per pupil per penny of tax effort.

The illustration on the next page is a conceptual summary of Tiers 1 and 2 of the Foundation School Program calculation.

[15] For these purposes, "capital outlay" is considered purchase made as part of a bond package for facilities and furnishings. Otherwise, a district could use Tier 2 funds to purchase a computer, for example.

Foundation School Program

Tax Rate

Tier 1- Basic Allotment

Basic Allotment $2,537

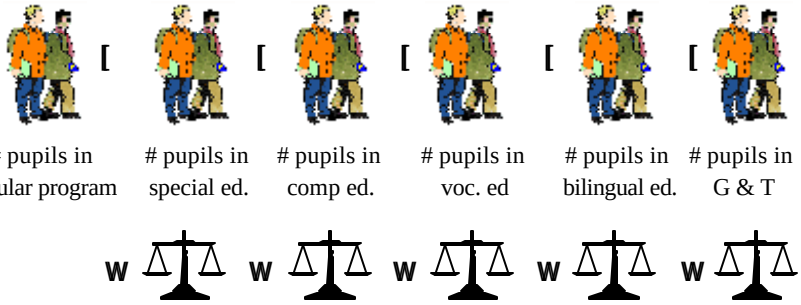
\+ **District Level Adjustments**

CEI

Small mid-size Adj (≤ 5000 ADA)

Sparsity (≥ 300 **9** mi)

\+ **Student Level Adjustments**



[# pupils in regular program

[# pupils in special ed. w Weights for special ed.

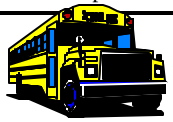
[# pupils in comp ed. w Weight for comp ed.

[# pupils in voc. ed w Weight for voc. ed

[# pupils in bilingual ed. w Weight for bilingual ed.

[# pupils in G & T w Weight for G & T

\+ **Transportation Allotment**



= **Total Tier 1**

.86

Total State and Local Tier 1 Funds

Tier 2 - Guaranteed Yield

each penny of tax efforts yields

W

$24.70

$24.70 per weighted ADA

1.50 Total State and Local Tier 2 Funds

Tier 3 Facilities

There are two state programs to provide assistance for debt repayment associated with school facilities. The Instructional Facilities Allotment (IFA) and the Existing Debt Allotment (EDA) are sometimes referred to as Tier 3.

Instructional Facilities Allotment

The IFA guarantees receiving districts $35 per unweighted ADA per penny of tax effort to assist in the payment of new instructional facility debt obligations.[16] Once a district receives state assistance under the program, the district is entitled to continue receiving the state assistance without reapplying to the commissioner of education. The related guaranteed level of state and local funds per student per penny of tax effort may not be reduced to a level below the level provided for in the year in which the bonds were issued. The state and local share for a district are adjusted annually to reflect changes in property values, ADA, and debt service. For instance, if the property wealth in a participating districts increased, the state share would be reduced to reflect this growth in local wealth. The reverse would happen if property wealth declined in a participating school district.

While the IFA is structured as a guaranteed yield similar to Tier 2, it does not guarantee that all districts that have received voter approval to sell bonds will receive IFA funding. Districts must apply to the Texas Education Agency (TEA) for state aid through the IFA. The IFA is a "sum certain" appropriation, which means when all of the appropriation is claimed (through the application process), no more money can be allocated by the TEA.

District property wealth is the central factor in determining which districts receive IFA funding. If IFA appropriations do not cover the demand in a given year, factors in addition to property wealth are considered in the application process. These additional factors include: whether the district was denied IFA assistance the prior biennium; substantial student growth in the preceding five years; and the absence of other outstanding debt. Each of these factors would allow a school district's wealth, for the purposes of ranking the applications for funding, to be lowered, thus allowing the district to move higher on the list for funding.

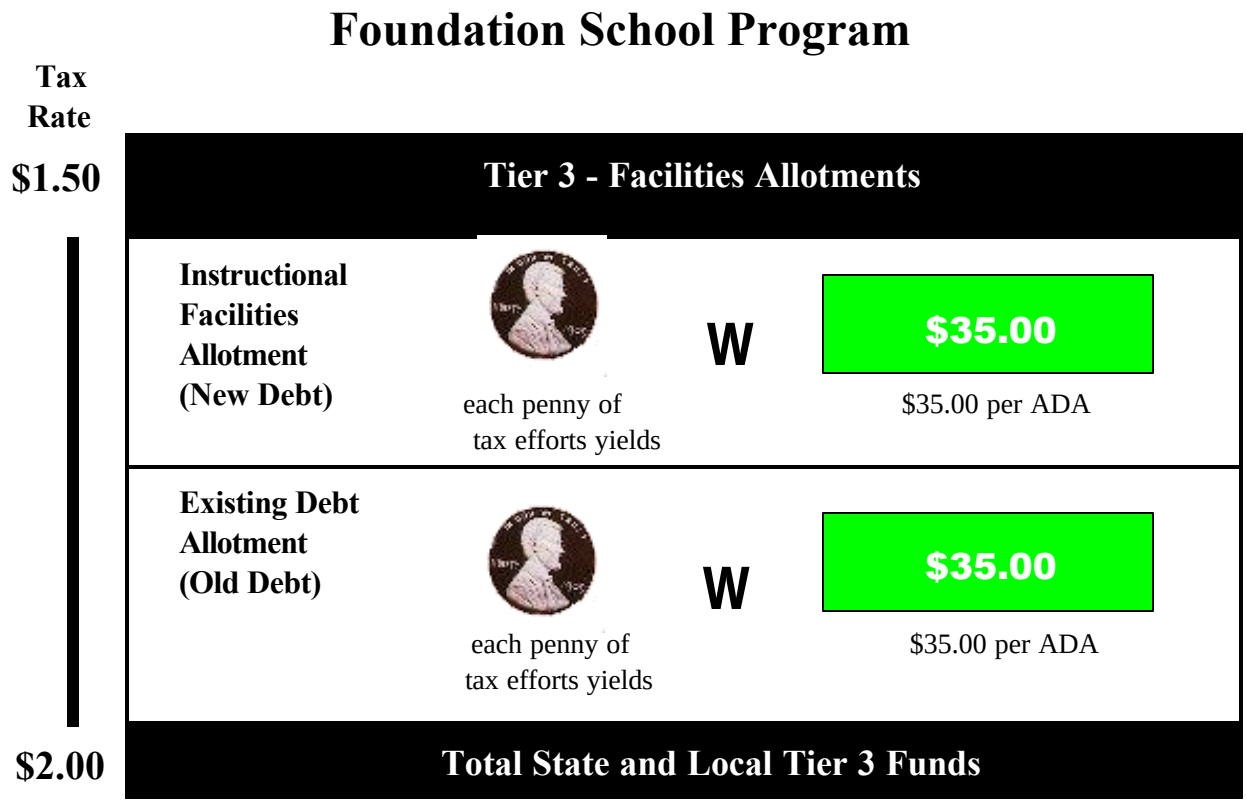
Most of the debt financed through this program is in the form of General Obligation (GO) bonds. The other primary financing arrangement is "lease purchase" agreements, which are a series of payments that are considered installments toward the purchase of a facility.

[16] The maximum district allotment is $250 per ADA per year, unless ADA is fewer than 400, in which case the maximum is $100,000 per district per year. (TEC §46.005)

Existing Debt Allotment

In the EDA, state assistance is provided through a guaranteed yield system ($35 per penny per ADA) for up to $0.12 of tax effort related to school district bonds. If additional funds are available, the commissioner of education could expand the number of pennies of tax effort eligible for assistance. (For the 2000-01 school year, the total number of pennies of tax effort covered is 29.) To be eligible, this tax effort had to be levied in the 1998-99 school year and may not be related to bonds for which the district receives IFA funds. Districts are required to reduce their I&S tax rate to reflect the amount of state assistance that, combined with local tax revenue, covers the principal and interest on the bonds.

The following illustration is a conceptual summary of Tier 3 of the Foundation School Program calculation:



Although it is not considered part of Tier 3, in 1999 the Legislature established a "New Instructional Facility Allotment." This $25 million annual allotment is intended to assist districts that experience growth in students. The first year a new school is open, the district would receive $250 per ADA. The second year the facility is open, the district would receive $250 per additional ADA at the school.

Equalized Wealth Level

Districts with per pupil property wealth that exceeds $295,000 are able to generate more than $29.50 per WADA per penny of tax effort without state assistance. These districts are often referred to as "Chapter 41 Districts." This ability to raise more revenue per tax effort is capped, however. In 1993 Senate Bill 7 established the "share the wealth" provision. Statute requires districts with per pupil property values that exceed $295,000 (prior to 1999, the limit was $280,000) to share their wealth by choosing one of the following five "recapture" options:

1. Consolidate with another (poorer) school district.
2. Detach property to another school district for taxation purposes.
3. Purchase average daily attendance credits from the state. The cost of a credit depends on a calculation that approximates the amount of tax revenue raised per child in the Chapter 41 District.
4. Contract for the education of non-resident students (partner with a poorer district). The cost of educating a non-resident student depends on a calculation that approximates the amount of tax revenue raised per child in the Chapter 41 District.[17]
5. Consolidate its tax base with one or more other districts.

The two most commonly employed choices are buying attendance credits from the state (writing the state a check), or sharing revenue with another district (writing a district a check). The number of districts subject to the recapture provisions range from 85 to 100 in a given year. The associated recapture revenue is anticipated to total $949.8 million in the 2000-01 biennium.

Since 1997, the equalized wealth limit applies to M&O taxes only. Interest and sinking tax effort (for facilities) is not subject to recapture.

In 1993, wealthy districts that would have faced abrupt decreases in revenue due to the "recapture" provisions were granted "hold harmless" protection. This hold harmless allows them access to a portion of their tax base above the equalized wealth level. The amount of the hold harmless is based on the wealth level necessary, assuming the district set a $1.50 tax rate, to maintain its prior spending level. While the hold harmless was initially included as a transition to the lower wealth level, this hold harmless protection has been made permanent. To qualify for the hold harmless, a district must choose option three – purchasing credits from the state.

In addition to the hold harmless, Chapter 41 includes other "discounts" that allow a recapture district to retain access to more than the $295,000 per WADA wealth level. The various discounts apply if a district has chosen option three or four.

[17] Since Chapter 41 districts generate more revenue per WADA than poorer districts, the receiving district benefits from a "premium" per WADA on the difference between the amount the Chapter 41 district pays and the amount the state deducts from the poorer district's FSP assistance.

State Funding Calculations

The state's share of funding is determined on a district-by-district basis. The state determines each district's "entitlement" based on the district's number of students, the characteristics of the district (adjustments) and the students (weights), the local tax base, and the local effective tax rate. Each district's local revenue (the product of the district tax base and tax rate up to $1.50) is then deducted from this entitlement to produce the state's funding portion.

It is important to note that the *local* share of funding is based only on the tax rate and the district's property base. Since student count is not part of this calculation, the local share does not increase with an influx of students. In other words, the state provides the full cost of funding each additional student.

TEA reconciles the past year's funding with each district's entitlement through a "settle up" process. Using actual pupil counts, collections, and property values, TEA retrospectively determines each district's appropriate funding and adds or subtracts funds from the district's current year funding allocation as needed. Districts that were "overpaid" in the previous year are subject to decreased funds throughout the current year, whereas districts that were "underpaid" are fully reimbursed in September of the current year.

For calculating state funding, a district's Tier 2 effective tax rate is limited to the effective rate imposed in the second year of the prior biennium (TEC §42.253 (e)). This provision is intended to establish predictability in state budgeting. Before this provision was adopted, there was a risk of "proration," which is a reduction in district revenues from the state due to budget shortfalls. Some have argued that this provision encourages school districts, seeking to maximize future state aid, to increase tax effort sooner than they might otherwise.

Set Asides

"Set asides" are a group of specific education programs that are funded with revenue that was appropriated from a particular student allotment (usually the Compensatory Education allotment) under the Foundation School Program. Once these set aside programs are authorized, their funding is deducted from the state allocation to each school district and then redistributed to districts according to the specifications of each set aside program.

This process of "setting aside" appropriated money is a method of funding education programs without seeking additional appropriations. Examples of programs funded in this manner are: the "Extended Year Program," which is an after-school or summer school remediation program; Texas Assessment of Academic Skills (TAAS) test administration; and Communities in Schools.

Set aside programs are expected to reallocate about $313 million in the 2000-01 biennium. The state withholds funds from each district through a proration formula and distributes the funds to districts that

operate eligible programs. "Chapter 41" districts receive funding credit for students in set aside programs, but they do not contribute to the set aside funding pool, because they receive no state funds that may be withheld.

Teacher Salaries

Teacher salaries make up more than 50 percent of a school district's operating budget, but they are not explicitly itemized in school finance formulas. Salaries are set by local districts and paid with local and state funds from Tiers 1 and 2.

The state does play a role in salary expenditures, however, through the "teacher minimum salary schedule" and more recently in the state mandated $3,000 annual salary increase for school teachers, librarians, counselors, and nurses. State law (TEC §21.402) sets a minimum salary a teacher could receive based on the number years of experience. State funding for the $3,000 salary increase was distributed to school districts not as a direct payment, but through Tiers 1 and 2 of the FSP. The basic allotment, the guaranteed yield in Tier 2, and the increase in the equalized wealth level ensured that all school districts received sufficient additional funding to cover the cost of the pay raises. By distributing the money through the funding formulas, the legislature retained the equity within the school finance system.

FEDERAL FUNDING

The federal government is contributing $4.1 billion to the Texas education system in the 2000-01 biennium, representing about 9 percent of total K-12 education revenues. These funds are distributed to specific programs that assist disadvantaged populations. The allocations are categorized in the General Appropriations Act as follows:

Federal Funds	**FY 2000 ($ mill.)**	**FY 2001 ($ mill.)**
Education and Welfare (Title 1 "disadvantaged" programs, special education, drug free programs, etc.)	**$1,336.2**	**$1,339.5**
Federal School Lunch Program (lunches and breakfasts; eligibility based on poverty level)	**$714.6**	**$715.4**
Other Federal Funds (Temporary Assistance to Needy Families. Mostly adult education and teen parenting programs)	**$9.1**	**$9.5**

APPENDIX A: OVERVIEW OF LITIGATION AND LEGISLATIVE RESPONSES, AND EQUITY MEASURES

While many of the structural elements of the current school finance system have been in place since House Bill 72 in 1985, the system has continued to be adjusted by the legislature to a greater or lesser extent every two years. The driving force behind these adjustments has been court rulings. The courts are not in a position to design an acceptable structure but, by repeated rulings on the constitutionality of system, have played a central role in shaping the school finance system. Public input and education interest groups have helped frame the legislative responses to these rulings.

The cornerstone of school finance litigation in Texas is Article 7, Section 1 of the state's 1876 Constitution:

> "A general diffusion of knowledge being essential to the preservation of the liberties and rights of the people, it shall be the duty of the Legislature of the State to establish and make suitable provision for the support and maintenance of an efficient system of free public schools."

Successive legal challenges to the system in Texas focused on the definition of "efficiency."

This appendix summarizes the history and influence of the courts on school finance in Texas. It concludes with a discussion of equity and the equity measures currently used to define an acceptable system. These equity measures are a result of the various court rulings and play a role in determining the funding level of the entire system.

Rodriguez v. San Antonio ISD

The state's funding structure was first challenged in a federal district court by Demetrio Rodriguez in 1968. He asserted in his lawsuit, *Rodriguez v. San Antonio ISD*, that the state's funding structure violated the "equal protection" clause of the U.S. Constitution's 14th amendment. This amendment was the basis of the *Brown v. Board of Education* case in 1954, in which the U.S. Supreme Court ruled that "separate but equal" educations are inherently unequal.

In 1971 the U.S. District Court ruled that the school finance system relied too heavily on local property wealth. In 1973 the U.S. Supreme Court, in a 5-4 decision, overruled the District Court, stating that education "is not among the rights afforded explicit protection under our Federal Constitution." The decision effectively removed public education financing from the federal arena and rendered it a state issue, to be determined in state legislatures and by state courts.

Even though the school finance system was upheld by the U.S. Supreme Court, legislative interest in revising the system was spurred. In 1975, in House Bill 1126, Tier 2 was established and the system was renamed the Foundation School Program.[18] The intent was to increase state aid to poor districts. Further adjustments in 1979 increased state aid and increased the fairness of property tax appraisals.

Edgewood v. Bynum

A Select Committee on Public Education began meeting in 1983. Its reform minded recommendations, released in early 1984, included school finance changes. That year, the Mexican American Legal Defense and Education Fund filed the first of the *Edgewood* cases, *Edgewood v. Bynum*. Filed in state court, the lawsuit challenged the equity of the school finance system

The legislature responded to these developments by approving House Bill 72 in 1985. The bill instituted many of the structural elements that are in place today, including "weighted" students, the "small / sparse" district adjustment, the use of "full time equivalent" units for special and vocational (now known as career and technology) education, and specific equalization funding.

Edgewood I – Similar Revenues at Similar Levels of Tax Effort

The Edgewood case went to trial in 1987 as *Edgewood v. Kirby* (William Kirby was the TEA Commissioner at the time). The State District Court found that the state's financing system violated both the "equal protection" (Article 1, Section 3) and the "efficient system" (Article 7, Section 1) clauses of the state's constitution. A state court of appeals reversed the decision in 1988, but the Texas Supreme Court unanimously affirmed the district court's ruling in 1989.

The Texas Supreme Court upheld education as a fundamental right under the Texas Constitution and cited "glaring disparities" in spending between wealthy and poor districts that violated the "efficiency" clause. Unlike the lower court, however, the Supreme Court did not demand "absolute equality" in per pupil spending to satisfy the "efficiency" clause. It created a standard of "substantially equal access to *similar* revenues per pupil at *similar* levels of tax effort." The court declared that "a remedy is long overdue" and set a deadline of May 1, 1990 for a legislative remedy. (This deadline was later extended to June 20.)

In June 1990, during the sixth called "special session," the legislature approved Senate Bill 1. The bill added a facilities component to the foundation school program definition, mandated that 95 percent of the state's students would be in a wealth-neutral system by 1995, and implemented adjustments to further assist less wealthy districts. It did not limit the enrichment capacity of wealthier districts.

[18] The Basics of School Finance, Sixth Edition, Revised 1996, p. 10.

Edgewood II and II-A County-Wide Tax Bases

The Edgewood case was retried in 1990 based on the "efficiency" of the system. In January 1991, the Supreme Court affirmed the lower court's rejection of Senate Bill 1, stating that its primary flaw was "its overall failure to restructure the system." The opinion, referred to as *Edgewood II,* noted that "...the system would be made more efficient simply by utilizing the resources in the wealthy districts to the same extent that the remainder of the state's resources are utilized" and called on the legislature to take immediate action.

A month later, in response to a motion for rehearing on one of the issues, the Supreme Court issued an advisory opinion that is sometimes referred to as *Edgewood II-A*. This opinion noted that: (1) local unequalized enrichment is not strictly prohibited; and (2) the Constitution allows the legislature to authorize an additional ad valorem tax to be levied and collected within all school districts for the maintenance of those public schools.

In 1991 the legislature responded with Senate Bill 351 which created 188 "County Education Districts" (CEDs). The CEDs consolidated the tax bases of several school districts within a county and thus "equalized" wealth among these districts. This consolidation applied to the first 72 cents of tax effort (this was to rise to $1.00 of tax effort in 1994-95). School districts retained the ability to tax above the CED tax rate. The grouping of the 188 CEDs was based on a maximum per student property valuation of $280,000 (to be phased in).

Edgewood III and Senate Bill 7 Recapture

By June 1991 the District Court heard arguments from wealthy districts challenging the constitutionality of the CEDs. The District Court upheld the system, but in January 1992
the Supreme Court ruled that Senate Bill 351 ran afoul of two constitutional provisions. The provisions were: Article 7, Section 3, requiring local voter approval of school property tax levies; and Article 7, Section 1-e, prohibiting a state property tax (outlawed since 1980). The ruling pertained to the nature of the tax itself; it did not address the equity of the school finance system. The Supreme Court allowed the system to stay in place for two school years, giving the legislature until June 1993.

The legislature met in a special session in 1992 and the regular 73rd session (1993) to correct the system before the June deadline. A constitutional amendment to allow for a statewide property tax and redress the defects of the CED structure was put before the voters on a May 1, 1993 ballot. The voters rejected the initiative by a wide margin, leaving the legislature with a month to come up with an acceptable system. The legislature responded with Senate Bill 7.

The most important and most controversial new element of Senate Bill 7 was its equalization / recapture formulas, which are directed at wealthier districts. The bill imposed a $280,000 cap (increased to $295,000 in 1999) on the per student taxable property value base in all districts.

Those districts with property values that exceed this limit must choose one of five methods to reduce their taxable wealth:

(1) Consolidate with another (poorer) school district.
(2) Detach and annex property to another school district for taxation purposes.
(3) Purchase average daily attendance credits from the state (write a check to the state). The cost of a credit depends on a calculation that approximates the amount of tax revenue raised per child in that district.
(4) Contract for the education of non-resident students (partner with a poorer district).
(5) Consolidate its tax base with one or more other districts.

Full implementation of Senate Bill 7 was scheduled for the year 2000. Until then, a number of wealthier districts would have been "held harmless," or permitted to retain a per pupil tax base that exceeds $280,000 per student. These districts were being "phased in" to the equalized system. (Subsequent legislation made this hold-harmless permanent.)

Edgewood IV

Senate Bill 7 was challenged in court as *Edgewood IV* based on the efficiency issue and on the issue of adequacy or "suitable provision" clause of the Texas Constitution. In December 1993 the District Court upheld Senate Bill 7 contingent on state funding for school facilities. In January 1995 the Supreme Court upheld the school finance system on all grounds, noting that it did not accept the challenge on facilities only because of an "evidentiary void." With regard to facilities, the court warned that, "the lack of a separate facilities component has the potential of rendering the school finance system unconstitutional *in its entirety* in the very near future." Otherwise, the court said the system met the constitutional level of efficiency because both rich and poor school districts had substantially equal access to the funds necessary to provide an accredited program. While disparities still existed in the level of tax effort needed in each district to generate the necessary funds, the court did not consider the disparity too great.

The court did caution that supplementation at the district level should not become so great as to destroy the efficiency of the system; and if a large number of school districts had to set at the maximum maintenance and operations tax rate ($1.50) to meet the accreditation standards, it could be viewed as an unconstitutional state property tax.

In 1995, in response to the warning in Edgewood IV, the Legislature established a $170 million school facilities grant program in Senate Bill 1. The bill's distribution formulas favored less wealthy districts. In subsequent action the legislature improved on school facilities funding efforts with the creation of the Instructional Facilities Allotment (IFA) in 1997 and Assistance with Payment of Existing Debt (EDA) in 1999 (both described in the body of this report). The $170 million in the 1996-97 biennium increased

to $200 million in the 1998-99 biennium. Combined appropriations for the IFA and EDA for the 2001-02 biennium are $1,296 million.

Edgewood V

A May 1998 lawsuit referred to as *Edgewood V* alleged that since the approval of SB 7 in 1993, the state has gradually eroded the equity of the school finance system through legislation and its application of the laws. The most significant of the issues raised included: extension of the "hold harmless" protection for Chapter 41 (wealthy) districts; elimination of recapture on debt service tax effort; and the absence of a revenue equalization mechanism for certain old debt payments.

The District Court chose not to hear the case while the legislature was in session. Senate Bill 4 was passed in May 1999 and included state assistance for up to 12 cents of school district tax effort for existing debt service. The bill increased the basic allotment in Tier 1

and the guaranteed yield in Tier 2, and provided additional assistance for new school facilities. Also, SB 4 raised the equalized wealth level from $280,000 to $295,000 and made the hold harmless provision permanent.

No further action on Edgewood V has been pursued.

Equity

The successive legal challenges to the system in Texas focused on the definition of "efficiency." An "efficient system of free public schools" has been interpreted in the courts as one that is equitable. Equity in this context is "horizontal" equity, which is defined as "equal treatment of equals," or roughly equal per pupil expenditures across school districts.

The primary elements of the current school finance structure were established in Senate Bill 7 in 1993. The most significant change in the school finance system since Senate Bill 7 is direct state facilities assistance, which expands access to state aid beyond the $1.50 tax rate.

The LBB continues to monitor and report the equity of the funding structure and any adjustments to the structure. Equity is a central component of the school finance structure in the sense that any proposed change to the school finance structure is evaluated in terms of its effects on equity. If adjustments diminish the equity of the system, the system may be open to a constitutional challenge.

Three primary measures of the structure's equity that were accepted by the Supreme Court in its approval of SB 7 in 1995. Based on the time of the ruling, these measures and their targets were:

- ***The percentage of total Foundation School Program revenue within the Equalized Funding System (target of 98 percent).*** This is defined as the proportion of FSP revenue either within the "guaranteed yield" thresholds or subject to "recapture." It includes all Tier 1 state and local revenue, all Tier 2 state revenue, Tier 2 local revenue up to the guaranteed yield level of $24.70 raised at tax efforts up to $1.50, various "hold harmless" funds, and state and local revenue raised through participation in the Instructional Facilities Allotment and Existing Debt Allotment;

- ***The percentage of students within the Equalized Funding System (target of 85 percent).*** This is defined as the proportion of students that attend school in districts with per pupil property wealth that falls within the Tier 2 "guaranteed yield" threshold ($247,000 per pupil);

- ***The variation in per WADA spending between those districts at the top of the wealth spectrum and those with below average wealth (target gap of no more than $600).*** This is calculated by comparing the average per WADA revenues in districts with per pupil wealth above the equalized wealth level with average per WADA revenues in districts that receive Tier 2 assistance. This comparison does not include revenue generated at tax rates above $1.50.

Changes in the Foundation School Program made in Senate Bill 4 in 1999, most notably the elimination of the use of Tier 2 funds for facilities purposes and the expansion of state assistance on tax effort outside the $1.50 tax rate cap, have prompted a reconsideration of how these equity measures are defined and calculated. The LBB continues to review the appropriateness of these three equity measures.

APPENDIX B: FREQUENTLY ASKED QUESTIONS

Q: What is the LBB school finance model and what does it predict?

A: The LBB school finance model simulates the funding formulas to determine the statewide Foundation School Program (FSP) appropriation. The model is used to reflect changes in enrollment, property values, and district tax effort. Also, the model is used to estimate the state cost of a proposed change in law and to provide insight into how the proposed change would affect individual school districts. The model is based on projections (depending on the time of year, some information is actual) of property value, student enrollment, and local tax setting decisions. The model provides a highly accurate statewide estimate of the implications of changes in the school finance system. Because of the inherent limits of projections and the vast differences in district characteristics, discrepancies may exist between the model and actual funding for an individual district.

Q: Why is state assistance based on year-old property values?

A: Current year property values are finalized by the Comptroller's Office in June. The use of current year values would require the Texas Education Agency (TEA) to determine a school district's state aid based on an *estimate* of final values. Using such an estimate would result in increased uncertainty in state aid for school districts and possibly larger fluctuations when TEA "settles-up" with school districts at the end of the year.

Q: Do school districts benefit when their property values increase?

A: School districts receive a one year benefit from an increase in values. Because school funding is based on a school district's wealth (calculated using prior year values), any increase in property values is not factored into the school finance system until the following year.

Q: What happens when school district property values decline?

A: Because state aid is calculated on prior year property values, districts experiencing property value declines do not generate state aid to offset all revenue lost due to value declines. If the property value decline exceeds four percent of taxable values, state appropriated funds are available to assist these districts.

Q: What do all the different tax rates mean?

A: The various tax rates (M&O, I&S, nominal, effective, compressed, and rollback) serve specific purposes for the generation of local revenue and as a basis for state funding. Each of these tax rates is defined in Appendix C (Glossary). M&O and I&S represent specific tax rates and limit how the related revenue can be spent. The nominal rate is what the school district adopts. The effective rate is what the state uses to fund districts. The compressed rate is also used for calculating state aid in certain circumstances. The rollback rate is related to local voters' ability to influence the amount of increase in the nominal tax rate.

Q: How are open-enrollment charter schools funded?

A: These schools are entitled to the same amount of state and local funding that would be spent on a student by the student's district of residence. They do not receive facilities funds. Statute implies that state funds are paid directly to the school and that local funds from the student's district of residence are paid to the school as tuition (no other tuition can be charged and the charter school must provide transportation). In reality, the school districts who have students transfer to a charter school do not pay local tax revenue to the charter school, but their share of state aid is reduced by the full formula cost of educating that child. Charter schools do not receive start-up funding from the state. At the beginning of the year, they do receive an "up-front" check from the state that is a small percentage of the school's projected state aid for the year.

Q: What is the difference between "transition aid" and "hold harmless" ?

A: The state generally provided "transition assistance" to districts to meet obligations related to state level increases in things such as teacher salaries. This assistance is generally considered temporary. A "hold harmless" attempts to protect districts from changes in the funding formulas that would result in districts receiving less total funding per student than it would have received without the formula change.

Q: Which option do most districts subject to recapture choose?

A: Almost all districts that have been subject to recapture since 1995 have elected to apply options (3) purchasing attendance credit from the state; or (4) contract for the education of non-resident students. (The one exception is the Tuloso-Midway ISD, which deeded industrial property to Corpus Christi ISD in 1993-Option 2). Certain "hold harmless" and "recapture discounts" provided in statute require districts to choose either Option 3 or 4 in order to receive the benefit. By July 15 of year, districts are notified if they are going to be subject to Chapter 41. In the 2000-01 biennium, recapture payments are projected to total $950 million.

Q: Can I&S tax effort be used to access state aid in Tier 2?

A: No. Senate Bill 4 (1999) limits Tier 2 to M&O tax effort and prevents state Tier 2 funds from being used for debt service. A State Board of Education rule (TAC §105.12) allows the basic allotment (Tier 1) to be used for certain debt service and lease-purchase payments.

Q: Are I&S taxes levied for lease-purchase payments?

A: Lease-purchase payment amounts are not I&S taxes, but are treated as "bond taxes" for purposes of state assistance under Chapter 46 (Instructional Facilities Allotment).

APPENDIX C: GLOSSARY

***Adjusted Allotment (AA)*:** The result of the Adjusted Basic Allotment being modified by the Small District or Mid-Size District Adjustment. The student allotments are then factored into the AA to determine program costs.

***Adjusted Basic Allotment (ABA)*:** The result of applying the Cost of Education Index into 71% of the Basic Allotment. The ABA is then adjusted by the Small and Mid-Size District Adjustment.

***Available School Fund (ASF)*:** The ASF is comprised of earnings from the Permanent School Fund (PSF) and 1/4 collections from the motor fuels tax. After paying for administrative costs of the PSF, a portion of the ASF is placed in State Textbook Fund, which includes funding for the technology allotment. The remainder of the ASF is distributed through the FSP based on the number of students in the district. This per capita distribution varies from year to year (usually between $250 and $300).

***Average Daily Attendance (ADA)*:** A method of counting students for the purpose of providing state aid to school districts. Currently, Texas counts students in attendance each day and averages the attendance count over the year.

***Basic Allotment*:** The minimum allotment provided for each student in attendance. It is adjusted to take into account district and student characteristics.

***Chapter 41 District*:** A school district whose property wealth exceeds $295,000 per weighted student. These districts are subject to the recapture provisions in Chapter 41 of the Texas Education Code.

***Compensatory Education*:** A program for students who are educationally disadvantaged. School districts receive funding for these students from the compensatory education allotment. The allotment is based upon the number of students participating in the federal free or reduced-price lunch program.

***Compressed Tax Rate*:** An element of SB 4 (1999) that uses a portion of an increase in state aid, delivered by increases in the funding formulas, to provide tax relief. This rate is for state aid purposes; not for local billing purposes.

***Cost of Education Index (CEI)*:** An adjustment to the Basic Allotment intended to reflect geographic and other cost differences beyond the control of a school district.

***County Appraisal District (CAD)*:** The political subdivision in each county responsible for appraising property for ad valorem tax purposes. The appraisal district is governed by a board of directors. Five directors are appointed by the taxing units that participate in the district.

***Effective Tax Rate*:** The rate used for determining state aid. It is calculated by dividing a district's prior year property value into its total property tax receipts, or "collections."

***Equity*:** In the context of school finance in Texas, the term has been referred to as requiring substantially equal access to similar revenue per student at similar levels of tax effort.

***Existing Debt Allotment (EDA)*:** In the EDA, state assistance is provided through a guaranteed yield system ($35 per penny per ADA) for up to $0.12 of tax effort related to school district bonds. If additional funds are available, the commissioner of education could expand the number of pennies of tax effort eligible for assistance. To be eligible, this tax effort had to be levied in the 1998-99 school year and may not be related to bonds for which the district receives Instructional Facilities Allotment funds. Districts are required to reduce (compress) their I&S tax rate to reflect the amount of state assistance that, combined with local tax revenue, covers the principal and interest on the bonds.

***Foundation School Fund (FSF)*:** Exists within the Foundation School Program and provides the bulk of the state funds used by school districts to pay teacher salaries, facility construction and renovation, administration, and other educational resource costs.

***Foundation School Program (FSP)*:** The system of funding formulas used to fund public schools. The FSP consists of three "tiers:" Tier 1 or "basic allotment;" Tier 2 or "guaranteed yield;" and Tier 3 or the Instructional Facilities Allotment and the Existing Debt Allotment.

***Guaranteed Yield*:** A school finance method to ensure that a school district generates no less than a certain amount of revenue per penny of tax effort. If a school district can not generate local revenue up to the guaranteed yield level, the state makes up the difference. The Texas school finance system provides a "guaranteed yield" in Tier 2 and in the Tier 3 allotments.

***Instructional Facilities Allotment (IFA)*:** It guarantees receiving districts $35 per ADA per penny of tax effort to assist in the payment of new instructional facility debt obligations. While the IFA is structured as a guaranteed yield, it does not guarantee that all districts that have received voter approval to sell bonds will receive IFA funding. Districts must apply to the Texas Education Agency (TEA) for state aid through the IFA.

***Interest and Sinking Fund (I&S) Tax Rate*:** Also called the debt service tax. I&S taxes pay for bonded indebtedness, facilities, and other capital needs. The I&S tax rate is limited to $0.50 on all debt issued after September 1, 1992. (TEC §45.003 (e))

***Legislative Budget Board (LBB)*:** Texas Education Code §42.007 charges the LBB with adopting a calculation of the equalized funding elements necessary to further the state policy (TEC §42.001) of a state-sponsored equitable, thorough and efficient system of public education. The LBB staff prepare a report for each legislature which fulfills this requirement. Also, LBB staff is responsible for a school finance model which is used to project the cost of an equitable Foundation School Program under existing legal parameters. Once approved by the LBB, that cost projection is used in the introduced version of the appropriations bill. The LBB prepares equalized education funding statements and other special reports on school finance for certain public education bills. School finance reports project the costs of current and proposed school funding formulas as well as the impact on system equity. The reports are prepared on a statewide basis, as well as by individual school district and legislative district. Current and historical data by school district are also available through this reporting system

***Local Fund Assignment (LFA)*:** A district's share of Tier 1 of the Foundation School Program. It is established by applying a $0.86 tax rate to the district's Certified Taxable Value for the preceding year.

***Maintenance and Operations (M&O) Tax Rate*:** M&O taxes pay for administration and operational costs. The M&O tax rate is limited to $1.50. (TEC §45.03(d))

***New Instructional Facilities Allotment*:** Established in SB 4 (1999), this $25 million annual allotment is intended to assist districts that experience fast growth in students. The first year a new school is open, the district would receive $250 per ADA. The second year the facility is open, the district would receive $250 per additional ADA at the school.

***Nominal Tax Rate*:** The tax rate adopted by the local school board and indicated on property tax bills.

***Permanent School Fund (PSF)*:** An endowment consisting of land and investment holdings. PSF interest is constitutionally dedicated (Article 7, Section 5) to the Available School Fund, which must be used for public education. In fiscal year 1999, the market value of the PSF was $19.6 billion. The State Board of Education administers the fund under constitutional and statutory requirements.

***Recapture*:** Revenue raised from school districts with wealth above the "equalized wealth level". Recapture applies revenue generated from M&O tax effort on wealth above $295,000 per weighted student.

***Rollback*:** A rollback election provides voters an opportunity to "roll back" proposed tax increases above a specified limit. Rollback provisions are designed to allow school districts to set a tax rate to generate the same amount of state and local revenue per weighted average daily attendance (WADA) as they had the prior year, plus $0.03 (for school year 1999-2000), plus debt service taxes. For the 2000-01 school year, the $0.03 increases to $0.06. A rollback election occurs if a school district set a tax rate greater than the rollback rate. If a majority of the district's voters disapprove of the tax rate, it is "rolled back" to the current tax rate.

***Technology Allotment*:** This allotment is distributed from the State Textbook Fund at a rate of $30 per pupil. It is used for the purchase of computers and other technology and for teacher training.

***Telecommunications Infrastructure Fund (TIF)*:** Established as part of the Texas Public Utility Regulatory Act of 1995 (HB 2128) to disburse up to $1.5 billion over 10 years to link Texas schools, hospitals, and libraries for distance learning and information sharing. A portion of these funds are appropriated to the Texas Education Agency for technology and information initiatives.

***Texas Education Agency (TEA)*:** Texas Education Code §7.021(b)(1) requires TEA to "administer and monitor compliance with education program required by federal and state law, including federal funding and state funding for those programs." Further, TEC §7.055(b)(7) directs the commissioner of education to "issue vouchers for the expenditures of the agency and shall examine and must approve any account to be paid out of the school funds before the comptroller may issue a warrant."

***Wealth per student*:** Is expressed as the taxable value of property in a district divided by the number of students in weighted average daily attendance. (TEC §41.001)

***Weighted Average Daily Attendance (WADA)*:** Is an adjusted student count that compensates for student and district characteristics as defined by statute. It is calculated by dividing the sum of the school district's allotments (both district adjustments and student allotments in Tier 1), less any allotment to the district for transportation, any allotment from the New Instructional Facilities Allotment (this is different from the Instructional Facilities Allotment), and 50 percent of the adjustment under the Cost of Education Index, by the basic allotment for the applicable year. (TEC §42.302(b))