Utah FOUNDATION Executive Summary

Report Number 682, January 2008

EQUALIZING SCHOOL BUILDING FUNDS

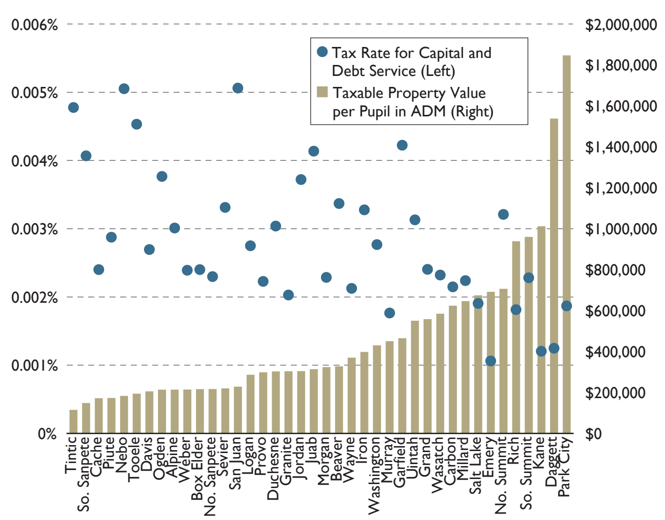
As Utahns brace for a massive influx of students into public schools over the next decade, concerns have been raised about where all the incoming students will be taught. In addition, the pending split of the Jordan School District has highlighted several issues as they relate to financing the building, maintaining, and renovating of Utah's school facilities. At stake are three central issues: capital financing issues, litigation concerns, and dividing the burden among taxpayers for financing capital facilities.

CAPITAL FINANCE ISSUES

In the 2007 fiscal year, school districts spent about $420 million on capital outlays for land and buildings, including remodels or additions to existing buildings. This is an increase of $156 million since 2000, when inflation-adjusted expenditures were $264 million.

The growing student population and rising building costs have raised concerns about the ability of individual school districts to finance adequate capital outlays. Projections indicate that growth in the K-12 student population will continue at a high rate. Over the next ten years, enrollment in Utah public schools is projected to grow by 155,824 students.[1]

Figure 1: School District Tax Rates for Capital Facilities and Debt Service Compared to Per-Pupil Property Values



Note: Pupils are counted in Average Daily Membership (ADM).
Source: Office of Legislative Research and General Counsel.

This growth in population points to a great need for schools in which to educate all of these students. If districts are unable to raise the necessary revenues, the adequacy of the facilities they provide to students is in jeopardy. Furthermore, there are great disparities in the per-student funds available to districts. This has raised concerns, in addition to adequacy, about the equity of school capital funding and facilities.

LITIGATION ISSUES

Nationwide, there has been a growing trend of litigation against states based on the inequity and inadequacy of school facilities. This has caused a number of states to legislate different forms of and programs for equalizing capital project funding statewide. As a result, the number of states with capital equalization programs has been growing.

Most of these cases have been brought on the basis of the constitutional obligation all 50 states have to provide a state public education system. Concerning educational finance overall, which includes operational finance, the past 30 years have seen 45 of the 50 states involved in litigation. School facilities financing has been included in 37 of these lawsuits. Furthermore, states are losing two-thirds of such cases and "No Child Left Behind" is not making the states' case any easier.[2]

TAX BURDEN ISSUES

The primary means of financing school capital projects is the property tax. A main concern about Utah's current method of financing educational facilities is the greatly disparate property tax burdens that are borne by Utah taxpayers residing in different school districts. In those districts where taxable values are high and growth is low, the burdens tend to be lighter. In certain high-growth and low taxable-value districts, the property tax burden is almost five times greater.[3]

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Figure 1 shows the assessed property value per pupil in each district compared to property tax rates levied for school facilities purposes. Note that the districts with the highest property values per pupil also generally have the lowest tax rates. Because the financial capacity or tax base of Utah's school districts varies so much, taxpayers in low property-value districts can have much higher tax burdens and receive lower quality facilities than those in high property-value districts. Not only do the buildings look different, but most importantly, they also present differing educational opportunities to students, with the more expensive buildings providing better science labs, technology, physical education facilities, libraries, and other educational enhancements.

CAUSES OF THE CAPITAL FACILITY FUNDING PROBLEM

The fundamental causes of these problems fall into two categories: external issues and systemic issues. External issues can be temporary and include Utah's rapid student population growth and the effects of school district splits. Systemic issues are ongoing problems with the current funding system that will not be solved without appropriate public policy changes. Utah's systemic issues include inequities in district resources and inequities in taxpayer burdens, both of which are caused by the current set of policies not responding effectively to the differences in local property values and local student growth rates.

CRITERIA FOR CRAFTING SOLUTIONS

Each of the problem causes described above call for unique policy objectives in crafting policy solutions. In order to address all of these problems, policymakers should consider the following objectives as policy solutions are considered. These objectives are primarily addressed at solving three major concerns: equity to students, equity to taxpayers, and the adequacy of school facilities.

1. Ensure that growing districts have adequate funds to build new schools to house additional students, in step with how much the student population increases in those districts.
2. Ameliorate the negative effects of splits on newly-formed districts that lose substantial resources.
3. Ensure adequate funding for renovations or rebuilds and maintenance across districts, as well as for new facilities.
4. Ease the burdens on taxpayers in lower taxable-value districts so that their property tax rates are more equivalent to other districts with higher taxable values.

EQUALIZATION

"Equalization" is the term used to describe the policies and programs that seek to achieve the objectives mentioned above and meet the criteria of equity and adequacy. Equalization of school capital funding is a complex issue, and it can be defined in several ways. Usually equalization is used as a way of setting a common, minimum standard or "floor," rather than creating a "ceiling" or limit, on the standards, features, or cost of facilities. What this means is that districts with larger funds still have the option of building schools to a higher standard and quality than the adequate level.

Capital Facilities Equalization in Utah

Utah currently provides aid for capital projects in the form of its Capital Outlay Foundation and Enrollment Growth Programs. The Capital Outlay Foundation Program distributes the funds allocated to it based on effort and need. Effort is determined by the proportion of a 0.0024% property tax rate that a district imposes. Need is determined by calculating how far a district's per-student revenues fall below a minimum amount at a tax rate of 0.0024%. The minimum per-student funding amount is set annually by the amount of funds appropriated in that year.

The Enrollment Growth Program distributes funds to districts that experience net enrollment growth and whose capital funding is below twice the statewide per-student average. While both the Capital Outlay Foundation and Enrollment Growth Programs serve to equalize capital funding to a degree, they make no inherent provision for adequacy because the aid districts receive is based on the amount of appropriated funds, rather than a certain level of adequate funding.

FINANCING SOLUTIONS

In creating new policies and programs designed to equalize capital funding, the mechanisms for acquiring and distributing enough dollars to fund capital projects at an adequate level must be considered.

Acquiring Funds

While the local property tax is currently the main source of district capital funds, state-controlled property taxes, the state income tax, and the state sales tax are all potential sources of revenue.

Using state-controlled property taxes might entail moving to a system similar to the Minimum School Program, which is used to fund school operations, in which districts levy and collect local taxes, but are subject to recapture when their yields are above a certain level.

The current source for state aid to districts is the state income tax, which is earmarked for education. This could be a viable source for additional facilities aid. However, it would compete with higher education and K-12 operational funding needs.

The state sales tax, which constitutes the greatest portion of the state general fund, could be used to help fund capital needs in districts. However, school capital facilities dollars would be competing with all other general fund needs.

Of the three main funding sources, property taxes would be the most stable revenue source, and income taxes would provide for the greatest equity among taxpayers. Equity among students would depend on how the funds are distributed.

Distributing Funds

In addition to determining where to acquire the funds for capital facilities, equalization policies need to consider *how* the funds are to be distributed. Just as with the choice of revenue sources, the choice of how to distribute funds affects how equitable the given policy or program will be.

The following are four basic, feasible ways of distributing capital funds from the state to the school districts. The way in which these alternatives are funded is not specified, as funding options have been addressed above.

Debt Supplements

This is aid in the form of low-interest or favorable-term loans from the state, state-subsidized loans or bonds, and extended or restructured repayment on loans or bonds, which are sponsored by the state.

Figure 2: Comparison of Modeled Alternatives to Current Capital Outlay Foundation Program

Scenario	Total State Outlay	Minimum Per ADM	Median Per ADM	Standard Deviation	Range (Max - Min)
Current Formula (2006-07 Fiscal Year)	$24,358,000	$528	$1,053	$591	$2,921
$1,000 Minimum Yield @ 0.0024% Qualifying Rate, Assuming Current Tax Rates	163,508,452	735	1,279	492	2,714
$53 Million Appropriation @ 0.003% Rate, Assuming Current Tax Rates	52,858,000	616	1,118	562	2,833
$53 Million Appropriation @ 0.003% Rate, Assuming Tax Rates Increase for Districts That Would Benefit	52,858,000	616	1,118	548	2,833
$1,000 Minimum, 50% Recapture over $2,000 @ 0.003% Enforced Rate	96,302,484	1,000	1,000	683	2,770
$1,000 Minimum, 100% Recapture over $2,000 @ 0.003% Enforced Rate	86,693,496	1,000	1,000	427	1,000
$1,000 Minimum, 50% Recapture over $1,000 @ 0.003% Enforced Rate	66,726,579	1,000	1,000	501	2,270
$1,000 Minimum, 75% Recapture over $1,500 @ 0.003% Enforced Rate	75,098,028	1,000	1,000	395	1,510
Full Equalization to $1,300 @ 0.003% Enforced Rate	177,527,784	1,300	1,300	0	0

Source: Utah Foundation.

Project Supplements
This is aid from the state in the form of grants for specific district capital projects. In this case, districts would apply for state grants and then qualify on the basis of certain criteria.

District Supplements
This is state aid in the form of funds dispersed to districts to ensure they have the resources necessary to provide all of their students with the minimum, adequate number and standard of facilities. Criteria would determine which districts lack the revenue necessary to ensure this minimum, adequate number and standard of facilities.

Status Quo
This is the current system for state aid for capital projects, including the Capital Outlay Foundation and Enrollment Growth Programs, at current funding levels.

MODELING POTENTIAL CHANGES TO THE CAPITAL OUTLAY FOUNDATION PROGRAM

In order to provide some guide as to the cost and implications of an equalization program, or a change in capital funding policies, Utah Foundation created a model, based on the Capital Outlay Foundation Program, to measure the effects of potential changes in the current formulas or levels of funding provided by the program. The model shows how various changes would affect the guaranteed amount of per-student funding and the actual funds available to individual districts, among other variables. The full report models six scenarios as shown in Figure 2. The effects of three of the scenarios are graphed in Figures 3, 4 and 5.

Equalization Task Force Proposal

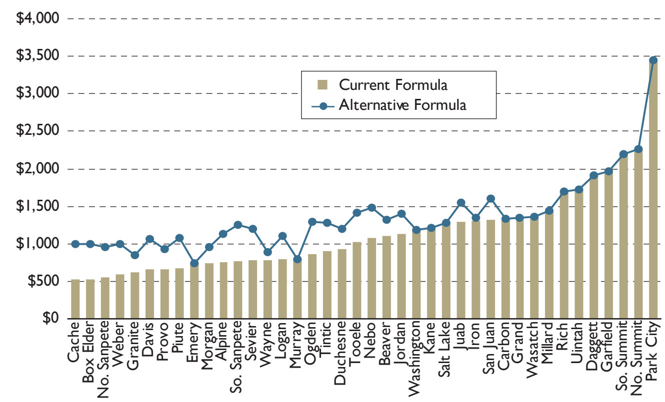
The first scenario models the effects of the proposal recommended by the Legislature's "Equalization Task Force." This proposal essentially uses the same formula as the current Capital Outlay Foundation Program, while raising the locally-levied property tax rate required for districts to receive their full share of state funds to 0.003%, and allocating $53 million in ongoing funds.

As Figure 3 shows, the additional funds provide assistance to a number of poorer districts, but the overall effects on adequacy, and especially on equity, are not considerably greater than the status quo.

Current Formula, with Funding at $1,000 Per Student

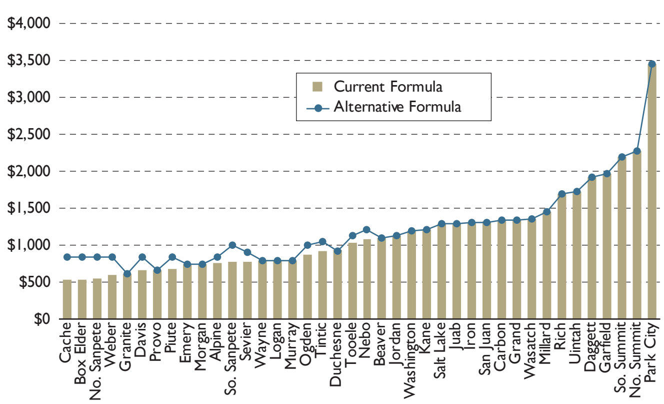
In the next alternative scenario modeled, the current Capital Outlay Foundation formula is used to ensure a minimum of $1,000 in

Figure 4: Existing Formula, Based on .0024% Qualifying Tax Rate, With Minimum Funding "Guarantee" of $1,000 Per ADM
State Cost: $164 Million



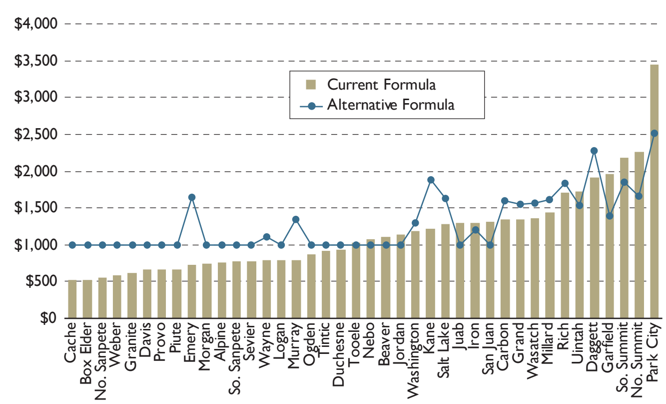
Source: Utah Foundation.

Figure 3: Change Qualifying Tax Rate to .003%, Assume Districts Raise Tax Rates to .003% if They Qualify for State Funding
State Cost: $53 Million



Source: Utah Foundation.

Figure 5: Require Tax Levy of .003%, Guarantee $1,000 Per Pupil Minimum, Recapture 75% of Funding Above $1,500 Per Pupil
State Cost: $75 Million



Source: Utah Foundation.

per-student capital revenue at the current tax rate for receiving full program funding, which is 0.0024%.

As Figure 4 shows, the minimum revenues per student would be brought up significantly among the poorer districts, while the effects on wealthier districts would be unchanged. However, at a cost of $164 million to the state, this alternative is much more expensive than the status quo.

$1,000 Minimum, With 75% Recapture Over $1,500

This scenario recaptures 75% of revenues above $1,500 per student that are generated by a 0.003% tax rate imposed in all districts. The recaptured revenues are then distributed among districts based on need.

Figure 5 and the statistics in Figure 2 indicate high performance on equity and adequacy measures, relative to the status quo and the other options presented here. This option would cost the state around $75 million.

ENDNOTES

[1] Utah State Office of Education, School Finance and Statistics: http://www.schools.utah.gov/finance/other/AnnualReport/06ar/Statistics/STUDENTS/State_Enrollment_Projections.xls

[2] Smith, Steve. *Education Finance Litigation: Overview, Research, & Trends*. Presentation at the Governmental Research Association Conference. July 26, 2005.

[3] *School Capital Outlay Funding*. Office of Legislative Research and General Counsel. November 2007.

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