

# ISSUE PAPER



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## **Funding Texas Public Schools The Target Revenue Approach**

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### **Background**

House Bill 1 (2006), the tax relief and school finance legislation passed in the 3<sup>rd</sup> Called Session of the 79th Legislature, changed the process for determining state aid to school districts. The legislation provided property tax relief by lowering the 2007-08 school district maintenance and operations (M&O) tax rate in each district to two-thirds of what it was in 2005-06. For districts with a \$1.50 tax rate in 2005-06, the 2007-08 M&O tax rate was compressed to \$1.00. For districts below \$1.50 in 2005-06, the compression resulted in a rate below \$1.00. The legislation did not affect debt service tax rates (I&S rates).

### **Hold Harmless Funding**

To make sure school districts did not lose revenue solely as a result of the tax relief measure, legislators provided a hold harmless feature for school funding called “target revenue.” The general approach is that each district had a per-student revenue target based on revenue per weighted student in 2005-06. If the target exceeded funding that would flow through the formulas in law, a district would receive target revenue funding. If the formula system generated revenue exceeding the target level, the district received only the target revenue.

### **Target Revenue – 2006 to 2009**

In the first year of the new finance law (2006-07), target revenue was set at the district’s revenue per weighted student in 2005-06 (or what the district’s revenue per weighted student would have been in 2006-07 under prior law) plus the \$2,500 teacher salary increase, a high school allotment of \$275 per student in grades 9 through 12, \$110 per weighted student, and any additional aid for declining enrollment, property value declines, and taxpayer protests. In 2007, legislators adjusted target revenue for changes in transportation from the base year, changes in tax credits from any Chapter 313 economic development agreements, district-determined changes in the optional homestead exemption (targets are reduced for districts that adopt or increase the optional homestead exemption), and adjustment of targets for any abatements that expire.

### **Target Revenue Funding Today**

In 2009, the Legislature passed HB 3646, a measure that increased school funding by \$1.88 billion by changing some critical finance formula factors. The basic allotment was increased to \$4,765, Tier 1 of the foundation program was defined as revenue at the compressed tax rate (not 86 cents), and the enrichment tier of the system was changed to reflect a higher yield for certain tax pennies.

The Legislature adjusted the targets to reflect revenue that would have been available in 2009-10 under prior law. The new targets were also changed to include the effects of hold harmless provisions dating back to 1997, the teacher pay increase, the high school allotment, and additional per-student revenue allotments from legislation passed in 2003 and

2007. In addition, the revenue target for mid-size high-wealth districts was changed to permit these districts to have the benefits of the mid-size district adjustment. However, despite legislative efforts to fund more districts through formula funding in Tier 1, more than 700 school districts remain on target revenue funding in 2009-10.

### **Enrichment Tax Rates**

In addition to funds generated at the compressed tax rate, school districts have access to 17 additional maintenance tax pennies in Tier 2 for enrichment. Six of the enrichment tax pennies each yield the same revenue that Austin ISD (a high-wealth district) generates. These six enrichment taxes are referred to as “golden pennies” because they have a high yield and recapture does not apply to them. Four of the golden pennies are available with school board approval. The fifth and sixth pennies must have both board approval and voter ratification.

Eleven additional pennies of enrichment tax in Tier 2 are available beyond the six pennies at the Austin level. Each of these 11 pennies has a \$31.95 yield and they are also subject to voter approval at a tax ratification election. Recapture will apply to the revenue raised by these taxes if the district has wealth exceeding \$319,500 per weighted pupil. From 2006 through 2009, school districts held 299 tax ratification elections or TREs. Voters ratified 208 or 70 percent of those measures.

### **Target Revenue Issues**

Targets are based on revenue per weighted student at a specific point in time and are not adjusted for changing requirements or inflation. The targets incorporate anomalies of a particular school year, leaving some school districts at a disadvantage and some districts at a comparative advantage. The variations are often incompatible with district resource needs. While the foundation program formulas are intended to support equity, the resource levels in Tier 1 are based on target funding, not the foundation program calculations, so equity is compromised. If the Texas Legislature were to adjust targets only for inflation, the inequities would persist.

### **Sources of Additional Revenue**

School districts have several ways to increase their revenue streams to fund operations.

- Districts may ask local voters to ratify a board-approved tax rate increase for enrichment taxes above the compressed tax rate.
- If enrollment increases, a district will receive greater total revenue because target revenue funding is based on weighted student attendance. But enrollment increases do not affect the amount districts receive per student; thus, districts will continue to serve new and existing students at out-of-date revenue levels. (Districts with declining enrollments will experience a reduction in their total revenue.)
- Districts can apply for state or federal program grants, but grant funds must be spent for purposes specified in the grant and not for other district needs.
- Educators and board members may ask the state legislature for increased state funding to help districts cover rising operating costs such as higher insurance premiums, cost of living adjustments for auxiliary staff, fuel, technology, and so forth.

### **Suggestions for Improvement**

Some changes would improve (but not undo) the target revenue system. These changes would increase state funding obligations.

- To reduce the wide range in district revenue targets, the legislature could move districts with low targets up to the state average or some other higher level.
- To improve equity and move more districts onto formula funding, the state could again increase the basic allotment.
- The state could adjust revenue targets for specific needs such as technology funding or middle-school improvements, even though such across-the-board changes could make the school finance system less equitable.

Another more ambitious approach to improvement is to devise a new equalized school finance system based on adequacy and equity requirements in law. A revamped school funding system should improve equity and link funding with districts’ instructional and student support responsibilities to better serve Texas students.