
Overview of the School Finance System

What you will learn:

- How the state provides financial support for public schools
- The basics of the Foundation School Program formula system
- About programs to assist school districts in paying debt service for facilities
- The results of recent Texas litigation regarding fairness and adequacy in school funding.

Key points:

- Local, state, and federal funds support Texas school districts, and Texas relies heavily on the local property tax to fund schools.
- State aid for schools declines when property values increase.
- The Foundation School Program formulas, Tier 1 and Tier 2 along with recapture, are intended to provide equity in school funding, but out-of-date formula elements and hold harmless provisions reduce system equity and adequacy.
- The Texas funding system is not linked to the cost of educating all students to meet state goals for performance.
- State and federal programs help school districts pay debt service on bonded indebtedness, but local property taxes play a major role in supporting construction and renovation of school buildings. Much of facilities funding is not equalized, reducing system fairness.

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Introduction

Public education is an enormous enterprise in Texas with 5.1 million students, 1,022 independent school districts, 182 charter school districts, over 8,500 campuses (including charter schools), and 656,000 employees.¹ Texas school districts budgeted a total of \$53.8 billion in 2015-16 to provide services and facilities to students, or \$10,177 per student. Of the \$53.8 billion, 55.3 percent was budgeted for instruction; 3.4 percent for general administration; 10.8 percent for principals, guidance counseling services, and instructional leadership; 11.4 percent for plant services; and 19.1 percent for other expenditures.

The amount spent for current expenditures² was \$8,718 per pupil.³ Texas ranks 45th in the nation in estimated K-12 public school current expenditures per student in 2013-14.⁴

Primary funding (about 89 percent) for this system of school districts comes from state and local sources.⁵ The mechanism for determining how school districts receive state financial support for operations is an allocation system called the Foundation School Program (FSP). Tier 1 FSP calculations identify state and local resource requirements for offering a basic, accredited education. The Tier 2 component of the allocation system is intended to provide enrichment resources from state and local resources.

This arrangement with shared state and local funding supports an equalized system where district resources for Tier 1 and Tier 2 are, or should be, based on district and student needs, not local property wealth level. In fact, the system for funding maintenance and operations is structured so that a district with a higher level of property wealth per student will raise more local funding and receive less state aid. Conversely, a district with a lower level of property wealth per student will raise less local funding and receive more state aid. The important principle to remember is that when property values increase in a district, the state reduces its aid to the school district.⁶

A similar equalization system exists for facilities funding wherein districts are guaranteed a minimum yield on each penny of debt service (I&S) tax from a combination of local and state funds. Currently, the guarantee level is \$35 per penny of debt service tax per pupil. School districts that can raise more than the \$35 yield from their own tax base don't receive state aid and keep all the local debt service tax revenue because there is no recapture for debt service revenue. This reduces the fairness of the system. The \$35 guarantee, adopted in 1999, is relatively low and many districts have too much property wealth to qualify for state financial support.

In theory, both the operations and facilities funding systems should level the playing field for resources among districts with different levels of property wealth. However, state funding constraints, hold-harmless provisions in law,⁷ and unequalized debt service taxes have resulted in equity gaps. Some higher-wealth districts raise and keep more revenue than their lower-wealth counterparts do at the same tax rate.

Sources of Revenue for School Districts

Local Revenue for Education: Local independent school district boards have authority to levy and collect property taxes. An appraisal district serves each county and assigns a value to each item of real property (buildings and land) and to taxable business personal property in the county. Every summer, the appraisal district provides an appraisal roll of taxable property situated in the school district. The district uses that roll to calculate the tax rate needed to fund educational programs and to compute taxes owed by each property owner.

The first task for school districts in calculating a tax rate is to determine the amount of local tax revenue needed to fund the operating budget and debt service requirements. Then the school board sets the tax rate that will generate that revenue. School district tax rates have two components: a maintenance and operations (M&O) tax and an interest and sinking fund tax for debt service. In 2015, M&O taxes averaged \$1.0627 per \$100 of taxable value, with a statutory maximum of \$1.17. Districts may adopt a tax rate of up to \$0.50 per \$100 of taxable value for I&S taxes at the time bonds are issued. In most cases, the I&S tax rate is lower than 50 cents, and some districts have no debt service taxes. The average 2015 I&S tax rate was \$0.2706.

The school district computes the levy, or taxes due, by multiplying the taxable value of property on the appraisal roll (divided by 100) by the total tax rate the district adopts. The district usually contracts with a city or county to send out tax bills and collect the revenue, but a few school districts collect their own taxes. Property taxes and other local funds accounted for \$24.9 billion or about 49 percent of all funds (including federal funds) for public education in 2015-16.⁸

Because property values vary widely among the Texas school districts that have taxing authority,⁹ it is not hard to find instances where a penny of tax in one district will yield two or three times as much as a penny of tax in another district. To reduce the revenue inequality resulting from tax bases of different sizes, the FSP drives state aid to districts with lower values, and the state recaptures resources from school districts with high property values. The goal for equalization is stated in the Texas Education Code section 42.001(b).

The public school finance system of this state shall adhere to a standard of neutrality that provides for substantially equal access to similar revenue per student at similar tax effort, considering all state and local tax revenues of districts after acknowledging all legitimate student and district cost differences.

State Revenue for Education: State aid comes from the Foundation School Fund; the General Revenue Fund; and special funds dedicated to education such as the Instructional Materials Allotment, Available School Fund, lottery proceeds, and the Property Tax Relief Fund. In the 2016-17 biennium, state aid for public education will be \$44.2 billion (excluding federal aid and resources for Texas Education Agency administration).¹⁰

Most school districts receive state aid to complement local property tax revenue and maintain the foundation program allocation. Some districts have sufficient property wealth to raise their foundation program funds with property tax revenue alone, but those districts may receive state funds for certain competitive grants and for a few programs that remain outside the FSP equalization system. High-wealth districts—those with property value per student in excess of a level the state sets—are subject to recapture of revenue.¹¹ Recaptured revenue flows back to the state General Revenue Fund and is available to offset the state's cost of supporting the foundation program. In the 2016-17 biennium, \$3.845 billion will be recaptured from school districts. That represents 9.1 percent of FSP state appropriations.¹²

Federal Revenue for Education: Federal funds serve a different purpose from state and local funds. Generally, they are intended to supplement educational programs the district offers. In some cases, federal funds are provided for very specific purposes, and some funds are expended at the state level. An example of a specific purpose is the federal program for free and reduced-price lunches for low-income students. Federal funds will account for 10 percent of all funds budgeted for Texas public education in the 2016-17 biennium.¹³

The Foundation School Program

For many years Texas has calculated state allotments and local revenue requirements from a system of formulas and calculations known collectively as the Foundation School Program (FSP). The specifics appear in Chapter 42 of the Texas Education Code. As mentioned above, the FSP has two components: Tier 1 and Tier 2. Tier 1 is a foundation program intended to support a basic, accredited

educational program. Tier 2 is intended to provide access to funds for program enrichment using a guaranteed yield approach. The state guarantees each district a minimum yield per weighted student on each penny of tax in Tier 2 from a combination of state aid and local revenue.

Tier 1: FSP calculations for Tier 1 begin with a Basic Allotment per student (\$5,140 in the 2015-16 school year). The formulas include upward adjustments for school district size and for regional cost differences that are outside the control of the district. The cost adjustment is called the Cost of Education Index, or CEI.¹⁴ The adjustments to the Basic Allotment result in an Adjusted Allotment per student which is larger than the Basic Allotment and unique to each school district.

Once the qualifying district adjustments are made, the formulas apply instructional program weights to the Adjusted Allotment to provide additional funds for programs such as compensatory education, special education, bilingual education, career and technology education, gifted and talented education,¹⁵ programs for students with a parent in the military, and the Public Education Grant program. The Adjusted Allotment is multiplied by the number of students in the program and then by a weight for each program.

Additional FSP components provide resources to districts for specific purposes. These include a high school allotment (\$275) for each student in grades 9 through 12, funding for the New Instructional Facilities Allotment (NIFA), and a transportation allotment. The NIFA allotment is explained later. Transportation is funded on a mileage reimbursement system that varies with the linear density of the school district's transportation system and with the category of the service (regular education, special education, career and technology education). Linear density is a measure of the number of miles a typical student is transported in the district, based on prior-year services. Reimbursement rates that the state uses are over 25 years old.

A school district's total Tier 1 allocation is the sum of the adjusted allotments for each instruction program (including the regular education program) plus the additional allotments for specific purposes. Tier 1 allotments vary widely among school districts because each has a unique profile of district and student characteristics. Each school district is then assigned a share of the cost for the Tier 1 program, called the local fund assignment (LFA). The amount of money needed for the LFA is determined by multiplying the district's M&O compressed tax rate by the taxable property value for the previous year as reported in the Texas Comptroller's annual property value study. If the LFA does not raise enough revenue to fund all of the Tier 1 allotment, the district receives state aid for the difference.

The current law provides for exceptions to the standard formulas for a set of districts that have historic revenue levels that exceed what the state system supports. This feature of additional state aid for tax reductions (ASATR) was adopted as a transitional mechanism in 2006 when tax compression was adopted, but it will persist through the 2016-17 school year when it is scheduled to end. Over 275 districts received ASATR in 2015-16.

To raise revenue for the LFA, the district must adopt a compressed tax rate of 0.6667 times the district's 2005 M&O tax rate. The majority of school districts have a \$1.00 compressed tax rate¹⁶ because their M&O rate in 2005 was \$1.50. However, the Basic Allotment is proportionately reduced if the district's compressed M&O tax rate is less than \$1.00, and until recently there was

no mechanism for districts to adopt a greater compressed tax rate. Beginning in 2015-16, school districts are allowed to shift the treatment of certain portions of the Tier 2 tax rate to fix this situation, commonly referred to as the “fractional funding” problem.

As mentioned above, the compressed tax rate is multiplied by the district’s taxable property value as determined by the Texas Comptroller to yield the Tier 1 LFA. The greater a district’s property value per student, the greater the LFA and the smaller the state’s share of Tier 1 funding. The wealthiest districts can raise their entire Tier 1 allotments with local property tax funds. They do not qualify for FSP state aid, and they may be required to participate in wealth equalization, or recapture, a process that limits their ability to raise and spend more money.

Tier 2: Tier 2 of the FSP provides additional funds to school districts. Tier 2 tax rates are those above the compressed tax rate up to a maximum of \$1.17. Tier 2 tax rates generate resources through a guaranteed yield program where one penny of tax rate yields a certain dollar amount per student from a combination of state and local sources. A low-wealth district raises as much revenue per penny as the tax base will allow. State aid will then be provided to bring the yield up to the guarantee level for each penny. Districts with moderate property wealth raise more funds locally and get less state aid per penny in Tier 2. High-wealth districts get little or no state aid in Tier 2 because they can raise the full guarantee level on each penny.

Tier 2 has two different yields. The first six pennies of Tier 2 (part 1) have a yield equal to that of Austin ISD, or \$74.28 in 2015-16.¹⁷ Because this is a relatively high yield, these six pennies are referred to as “golden pennies.” Revenue from these taxes is not subject to recapture provisions, so districts with wealth that exceeds Austin ISD’s keep the additional revenue they generate. The remaining 11 Tier 2 enrichment pennies (part 2) have a yield of \$31.95 per penny per weighted student. Districts with wealth exceeding \$319,500 per weighted student are subject to recapture for these pennies of tax. School boards may adopt an M&O tax rate of up to \$1.04. To exceed this tax rate level, districts must conduct a tax ratification election in which voters have an opportunity to approve or reject a tax rate increase above \$1.04 and up to \$1.17.

Weighted Average Daily Attendance (WADA): The weighted pupil funding approach lets the finance system recognize additional costs that are beyond the control of a school district. As mentioned earlier, these costs will vary depending on the district characteristics and student educational needs. Weighted average daily attendance (WADA) is calculated by first taking the total Tier 1 allotment for the district. From this allotment transportation funds, the NIFA allotment, and the high school allotment are subtracted. Then the effect of the CEI on the WADA calculation is reduced by half. Once these calculations are complete, WADA is computed by dividing the result by the Basic Allotment. WADA will be greater than average daily attendance (ADA). On a statewide basis in 2015-16, ADA is 4,770,400 and WADA is nearly 6,388,400. (WADA is 1.34 times ADA.) The state uses WADA to calculate Tier 2 funding.

Recapture: In 2015-16, school districts with property wealth per WADA above \$514,000 are subject to Tier 1 wealth reduction provisions of Chapter 41 of the Texas Education Code. In Tier 2, districts with property wealth per WADA above \$319,500 experience recapture on revenue from the eleven pennies of tax in Tier 2, part 2. Each district with a tax base per WADA above

the equalized wealth level must reduce its property wealth by giving up access to M&O taxes produced by the excess property tax base. Recapture is not imposed on property tax revenue generated by the golden pennies or by I&S tax rates.

To reduce taxable value per student, higher-wealth districts may consolidate with lower wealth districts, detach property taxable by the district and annex that property to another district, purchase attendance credits from the state, contract with a lower-wealth district for the education of some of its students, or consolidate tax bases with one or more districts with lower property wealth. Most districts elect to purchase attendance credits or contract for the education of students in another district. These decisions have the effect of artificially increasing WADA and thus reducing property wealth per WADA down to the required level.

In summary, calculation of M&O revenue consists of two main components, Tier 1 (state aid, compressed taxes, and recapture) and Tier 2, part 1 (the Austin tax yield on up to six pennies of tax above the compressed rate) and Tier 2, part 2 (a \$31.95 yield for each of the additional 11 pennies of tax, up to 11 cents). Within Tier 1 there are a number of adjustments, weights, and allotments that distribute funding according to characteristics of school districts and students. Tier 2 provides for equal access to additional funds using a guaranteed yield calculation. As a result of these formulas, there is more uniformity of revenue per WADA across the range of school district wealth than there would be otherwise. Disparities that exist largely result from differences in adopted tax rates as well as differences in property wealth per student and hold harmless provisions under current law.

Target Revenue and ASATR

Superimposed on the FSP formulas is a target revenue system that was implemented in 2006 along with school property tax reduction. Law required school districts to reduce or compress 2005 M&O tax rates by one-third by 2007. This requirement, by itself, would have significantly reduced revenue available to school districts, so the legislature created a hold harmless provision to substitute state aid for the lost school property taxes. Calculation of hold harmless aid is still a feature of the current system. When planning the annual budget, districts calculate a revenue target and compare it to revenue that would be available through the formulas. If the formula-based revenue falls short of the target, a district receives hold harmless revenue to bring it to the target level (also called Available State Aid for Tax Reduction or ASATR). In 2008-09, most districts were funded using the target revenue system. Over time property values have risen and the finance system has changed so most districts are funded through the formulas in 2015-16. ASATR and the target revenue system will end in 2017.

Facilities Funding

Texas employs two programs to fund school facilities, the Instructional Facilities Allotment (IFA) and the Existing Debt Allotment (EDA). IFA is a competitive grant that makes state support available either for debt service payments on qualifying bonds or lease-purchase agreements for new instructional facilities. Districts in which voters have granted the board authority to sell bonds to fund instructional facilities may apply for state assistance before an I&S tax (or debt service tax) is levied to pay the debt service. If granted, annual IFA assistance is based on the amount needed to service the debt and is limited to the lesser of the annual debt service payment or \$250 per ADA. Districts with 400 students or fewer are eligible for the lesser of \$100,000 per year or their

actual debt payment. If a district participates in the IFA program, the district's I&S taxes and state aid will combine to yield \$35 per penny per pupil. This is a higher yield per penny than many low-wealth districts would generate from local property taxes, and the program has the effect of lowering I&S tax rates in those districts receiving IFA support. The Texas Legislature appropriated \$55.5 million for IFA grant assistance for the 2016-17 biennium.

The Texas Legislature also appropriates funds for a program to help school districts pay for existing bonded debt. The EDA program guarantees school districts \$35 per penny per ADA up to a maximum of \$0.29 of debt service taxes to service bonds for which the district has already levied I&S taxes. There is no application for these funds; they are automatically available to help service qualifying debt in districts with property wealth less than \$350,000 per ADA. In 2015-16, bonds for which districts levied a debt service tax in 2014-15 will automatically qualify for EDA support. A specific bond may not be supported by both IFA and EDA, but a number of districts have some bonds that receive IFA funding and other bonds with EDA support.

The \$35 per penny per ADA guaranteed yield for IFA and EDA has remained unchanged for more than 15 years. During that time period district property wealth levels rose, and fewer districts now qualify for any state support for facilities because the local tax base raises the full guarantee amount. Today, fewer than 50 percent of Texas students attend school in districts eligible for state EDA assistance, compared to 90 percent of students when the program was implemented in 1999. An increase in the yield per penny would mean more districts would be eligible for state support through the EDA finance program. More state support through these programs would permit districts to lower debt service taxes, but the state support would not be additional revenue for the district to spend at its discretion.

Other Sources of Support for Facilities and Infrastructure

The New Instructional Facilities Allotment (NIFA) assists school districts with the operating cost of opening a new school. The first year a new school is open, the district is entitled to an allotment of \$250 per student. In the second year, the district is entitled to a \$250 allotment for each additional student at the school. In 2011 and 2013, the Texas Legislature did not provide biennial funding for NIFA, but assistance resumed for the 2016-17 biennium.

Tax increment financing (TIF) is a tool that local governments can use to finance structural improvements and enhanced infrastructure within a reinvestment zone. The intent is usually to stimulate economic development, increase employment, and/or make cities more attractive to work in and visit. A reinvestment zone can be initiated by petition of the affected property owners, or a municipality can initiate a reinvestment zone without the need for a petition. School districts do not initiate reinvestment zones, but they may participate in them and benefit from improvements such as new access roads as well as the eventual increase in the value of property in the zone.

Budget Cuts in 2011

Legislators met in 2011 to balance the state budget in the face of significant revenue shortfalls. When the Legislature concluded its work, it had cut funding for every area of state government responsibility including public education. FSP funding needs were cut by \$4 billion for the 2012-13 biennium. In addition, legislators cut \$1.4 billion of discretionary grant funding for

schools. Legislators implemented an across-the-board approach to cuts in 2011-12. In 2012-13, a hybrid plan cut more revenue from districts funded with target revenue. Despite increased appropriations in 2013 and 2015, the additional resources have not erased all of the effects of cuts made in 2011.

School Finance Litigation, 2012-2016

Four school district plaintiff groups representing more than 600 districts went to court in 2012 to challenge the constitutionality of the state's system for funding schools. The school district groups argued that the current system is inequitable and inadequately funded. They also argued that the property tax for schools operates like an unconstitutional state property tax. School district plaintiffs were joined by a plaintiff intervenor group of charter schools that argued the system was inadequate and unfair because charter schools do not receive state assistance for facilities. A business group also joined the plaintiffs arguing that the system is inefficient. The trial entered a second phase in early 2014 to consider new evidence from student test performance and legislation passed during the 2013 legislative session.

In his Final Judgment, issued August 28, 2014, Travis County District Court Judge John K. Dietz ruled for the plaintiff school districts and against the State defendants and the plaintiff intervenors. The written decision declared: "The Texas school finance system is constitutionally inadequate, unsuitable, and financially inefficient."

The State appealed the district court ruling directly to the Texas Supreme Court and was joined by the charter schools and the business intervenors. The supreme court held oral arguments September 1, 2015.

On May 13, 2016, the Texas Supreme Court overturned the district court ruling¹⁸ and declared that, "Despite the imperfections of the current school funding regime, it meets minimum constitutional requirements." The Court added that Texas school children "deserve transformational, top-to-bottom reforms that amount to more than Band-Aid on top of Band-Aid. They deserve a revamped, nonsclerotic system fit for the 21st century."

Conclusion

State government and local school districts share responsibility for funding Texas public schools. Legislators crafted a funding system with a Tier 1 foundation program, a Tier 2 guaranteed-yield program, a facilities funding component, and a mechanism for recapturing funds from high-wealth school districts to constrain them from higher spending levels. The Texas Supreme Court has found the system to meet minimum constitutional requirements.

Useful Resources

Texas Legislative Budget Board, "Foundation School Program Overview," March 2016.
www.lbb.state.tx.us/Documents/Publications/Issue_Briefs/3099_PE_FSP.pdf.

TTARA Research Foundation, "An Introduction to School Finance in Texas," June 2014.
ttara.org/files/document/file-53cd2d02a5c99.pdf.

Texas Education Agency, “School Finance 101,” September 2014.
At this web site and select the link to either the PDF version or the Word version of the report.
tea.texas.gov/Finance_and_Grants/State_Funding/Manuals/School_Finance_Manuals/.

Texas Education Agency, “School Finance Topics.”
tea.texas.gov/Finance_and_Grants/State_Funding/Manuals/School_Finance_Topics_-_One_Page_Descriptions/.

Texas Association of School Boards, “Issue paper: Weights and Allotments,” 2014.
tasb.org/legislative/documents/weights.pdf.

Texas Association of School Boards, “Funding Texas Public Schools, The Target Revenue Approach,” February 2010. tasb.org/legislative/resources/documents/issue_targetrev.pdf.

This document is provided for educational purposes only and contains information to facilitate a general understanding of the law. It is neither an exhaustive treatment of the law on this subject nor is it intended to substitute for the advice of an attorney. It is important for the recipient to consult with the district's own attorney in order to apply these legal principles to specific fact situations.

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- ¹ Snapshot 2014 Summary Tables: State Totals. Prepared by the Texas Education Agency. Available at: rptsvr1.tea.texas.gov/perfreport/snapshot/2014/state.html.
 - ² Current expenditures do not include debt service and capital outlay for facilities.
 - ³ 2015-16 Budgeted Financial data: Totals for State Total. Prepared by the Texas Education Agency. Available at: rptsvr1.tea.texas.gov/cgi/sas/broker?_service=marykay&_program=sfadhoc.budget_report_2016.sas&_service=ap_pserv&_debug=0&who_box=&who_list=STATE.
 - ⁴ Texas Legislative Budget Board, *Fiscal Size-Up 2016-17*. May 2016, p. 242, figure 182.
 - ⁵ Texas Education Agency, *Pocket Edition, 2013-14*. Available at: tea.texas.gov/communications/pocket-edition/.
 - ⁶ By contrast, city and county resources are permitted to increase when property values rise.
 - ⁷ Hold-harmless features provide money to school districts that were otherwise subject to revenue reduction. Districts may be held “harmless” or protected from revenue losses.
 - ⁸ *Fiscal Size-Up*, p. 227, figure 169.
 - ⁹ Charter schools and school districts on military bases lack a tax base and do not have taxing authority. South Texas ISD in Mercedes, TX, has a unique funding system with respect to property taxation.
 - ¹⁰ *Fiscal Size-Up*, p. 225, figure 168.
 - ¹¹ They still receive funds from any competitive grants and from some programs outside the FSP equalization system like the high school allotment.
 - ¹² *Fiscal Size-Up*, p. 229, figure 171.
 - ¹³ *Fiscal Size-Up*, p. 229.
 - ¹⁴ The Cost of Education Index was last updated in 1991.
 - ¹⁵ Program weights date back to the mid-1980s. The state has not updated most of the weights since that time. See: tasb.org/legislative/documents/weights.pdf.
 - ¹⁶ In 2015-16, 40 school districts reported M&O tax rates below \$1.00.
 - ¹⁷ In 2016-17 the Tier 2, part 1 yield rises to \$77.53.
 - ¹⁸ Texas Association of School Boards, “Eight Things Texans Should Know About the Ruling,” May 2016. tasb.org/Legislative/Issue-Based-Resources/documents/160606-8things.pdf.