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Texas School Finance System Overview

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Public education is an enormous enterprise in Texas.[1] About 90 percent of funding for Texas school districts comes from state and local sources with the remainder coming from federal and other sources. The state funding mechanism, known as the Foundation School Program (FSP), comprises a system of formulas and calculations used to determine state allotments and local revenue requirements for each district (the district's FSP entitlement). The FSP consists of two tiers (Tier 1 and Tier 2) and facilities funding.

This shared state and local funding arrangement supports an equalized system where district resources are based on district and student needs, not local property wealth. In fact, the system for funding maintenance and operations is structured so that a district with higher property values will raise more local funding and receive less state aid. Conversely, a district with lower property values will raise less local funding and receive more state aid. Under current law, districts are limited to 2.5 percent growth in values from the prior year. Value growth above that is factored in to compress the district's tax rate.

Sources of Revenue for School Districts

Local Funds: Public school boards have authority to levy and collect ad valorem property taxes. Every summer, the appraisal district produces the certified appraisal roll of taxable property value in each school district. The district submits information from its certified appraisal roll to the Texas Education Agency (TEA) to calculate the district's *maximum compressed tax rate* (MCR). A district's MCR (or Tier 1 tax rate) is the rate for the current tax year per $100 of taxable property value at which the district must levy a maintenance and operations (M&O) tax to receive its full Tier 1 allotment under the FSP. The board may levy an additional $0.17 in Tier 2. If the board exceeds its *voter-approval tax rate* (VATR), it must conduct an election for voters to approve the adopted tax rate.

The board also imposes an interest and sinking fund (I&S) tax (also referred to as debt service tax) to generate funds required to service the district's debt. Except in very limited circumstances, a district's maximum I&S rate is $0.50.

[1] State-level statistics on the state public school system, including information on finances, personnel, accountability ratings, students, test performance and participation, graduation and college admission, attendance, and graduation completion and dropout rates, are available in the Texas Education Agency Pocket Edition published annually. PEIMS Financial Standard Reports, including annual financial budget reports for each district and statewide.

Because property values vary widely among Texas school districts, it is not hard to find instances where a penny of tax in one district will yield significantly more than a penny of tax in another district. To reduce this revenue inequality, the FSP drives state aid to districts with lower property values, and the state recaptures revenue from school districts with higher property values. The goal for equalization is stated in Texas Education Code section 48.001(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 Aid: State aid comes from the Foundation School Fund; the General Revenue Fund; the Property Tax Relief Fund; and special funds dedicated to education, such as the Instructional Materials Allotment, Available School Fund, and lottery proceeds. In the current biennium, state aid for public education will be $55.9 billion (including federal funds, regional education service center funding, and resources for the Texas Education Agency).[2]

Most school districts receive state funds to supplement local property tax revenue and maintain the district's FSP entitlement. Some districts have sufficient property wealth to generate their FSP entitlement with property tax revenue alone, but those districts may receive state funds for certain competitive grants or for programs outside the FSP equalization system. High-wealth districts—those with a local share in excess of the district's entitlement—are subject to recapture of excess revenue. Recaptured revenue flows back to the state General Revenue Fund and is available to offset the state's cost of supporting the FSP. The state redistributes billions of dollars of recaptured revenue annually.[3]

Federal Funds: Federal funds serve a different purpose from state and local funds. Generally, they are intended to supplement a district's educational programs. In some cases, federal funds are provided for very specific purposes, and some funds are expended only at the state level. Texas public education receives billions of dollars in federal funding each year for programs such as free and reduced-price lunches for low-income students or Title 1. Under the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed in response to the Covid-19 pandemic, Texas received an additional $1.2 billion in federal funding for education. TEA confirmed that this funding would likely supplant state resources where reductions in state revenues have depleted funds that would have been dedicated for public education.[4]

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2 House Bill 1, Article III: Education. 86th Texas Legislature, 2019.

3 The estimated amount of recapture can be found in the Comptroller's Biennial Revenue Estimate.

4 For more information, see Tex. Educ. Agency, *CARES Act Funding and COVID Expense Reimbursement FAQ*.

The Foundation School Program

Texas Education Code chapter 48 sets out the FSP. The FSP seeks to guarantee that each district has adequate resources to provide each eligible student a basic instructional program and facilities suitable to the student's educational needs, and access to a substantially equalized program of financing in excess of basic costs for certain services. The FSP consists of a facilities component and two tiers that work to provide (1) sufficient funding for all districts to provide a basic program of education that is rated acceptable or higher and meets other legal requirements (Tier 1); and (2) substantially equal access to funds to provide an enriched program (Tier 2). Tier 1 consists of a basic entitlement, also known as the basic allotment, and student-based allotments. Tier 2 uses a guaranteed yield approach in which the state guarantees each district a minimum amount of state and local funds per weighted student for each penny of Tier 2 tax effort.

Tier 1: FSP calculations for Tier 1 begin with a basic allotment per student (currently $6,160). A sparsity adjustment applies for certain small districts. Districts are then entitled to student-based allotments. Small and mid-sized districts receive an allotment based on size. Several allotments apply weights to the basic allotment to provide additional funds for students in various instructional programs such as compensatory education, special education, bilingual education, career and technology education, and the Public Education Grant program. The FSP also provides other allotments, including an allotment for students with dyslexia or related disorder; an early education allotment for certain students in kindergarten through third grade; a college, career, or military readiness outcomes bonus; a fast growth allotment; a teacher incentive allotment; and a mentor program allotment.

Additional FSP components provide resources to districts for specific purposes. These include the New Instructional Facilities Allotment (NIFA) and a transportation allotment. The NIFA allotment is discussed below. The transportation allotment is based on a rate per mile per regular eligible student.

A school district’s total Tier 1 entitlement is the sum of the basic entitlement, the student-based allotments, and 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 district is responsible for a share of its Tier 1 entitlement, called the local fund assignment (LFA). The amount of a district’s LFA is determined by multiplying the district’s Tier 1 M&O tax rate by the taxable property value for the current year as reported in the Texas Comptroller’s annual property value study. If the LFA is less than the district’s Tier 1 entitlement, the district receives state funds to make up the difference.

The greater a district’s property value per student, the greater its local share and the smaller the state’s share of Tier 1 funding. The wealthiest districts will generate their entire Tier 1 entitlement with local property tax funds. These districts will not qualify for FSP state funds and may be required to reduce their Tier 1 local revenue level to a level not to exceed their entitlement. This process is often referred to as recapture, and a district has several options for reducing its local revenue. These options are set out in Texas Education Code chapter 49 and include consolidation with another district, detachment of district territory, purchase of average daily attendance credit, education of nonresident students, or tax base consolidation. Most districts elect to purchase attendance credits or contract for the education of students in another district.

Tier 2: A district's Tier 2 tax rate consists of the tax effort above a district's MCR up to a maximum of an additional $0.17. 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 district raises as much revenue per penny as the tax base will allow. State funds then bring the yield up to the guarantee level for each penny. Districts with moderate property wealth raise more funds locally and get less state funding per penny in Tier 2. Higher-wealth districts get little or no state aid in Tier 2 because they raise the full guarantee level on each penny.

Tier 2 has two components with different yields. The first eight pennies of Tier 2 have a yield equal to the greater of the amount of tax revenue per weighted student per cent of tax effort available to a district at the 96th percentile of wealth per weighted student or the amount that results from multiplying the basic allotment by 0.016 (currently $98.56). Because of this higher yield, these eight pennies are referred to as *golden pennies*. Revenue from a district's golden pennies is not subject to recapture. The remaining nine Tier 2 enrichment pennies yield the amount that results from multiplying the basic allotment by 0.008 (currently $49.28). Revenue generated by these so-called *copper pennies* is subject to recapture Thus, a district with revenue in excess of the guaranteed yield for its copper pennies must reduce its revenue to that level.

Facilities Funding

The FSP includes two programs to fund school facilities: the Instructional Facilities Allotment (IFA) and the Existing Debt Allotment (EDA). The IFA is a competitive grant that provides state support for debt service payments on qualifying bonds or lease-purchase agreements for new instructional facilities. If granted, annual IFA assistance is based on the amount needed to service the debt and is limited to the lesser of the following: the actual debt service payment or the greater of $250 per ADA or $100,000. 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.

The EDA helps school districts pay existing bond debt by guaranteeing a yield between $35 and $40 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. These funds are automatically available to help service qualifying debt in eligible districts; there is no grant application. A specific bond may not be supported by both IFA and EDA, but a district may have bonds that receive IFA funding and other bonds with EDA support.

The NIFA is an allotment under Tier 1 that assists school districts with the operating costs of opening a new school. The first year a new school is open, the district is entitled to an allotment of $1,000 per student. In the second year, the district is entitled to a $1,000 allotment for each additional student at the school. The amount appropriated for the NIFA may not exceed $100 million in a school year.

Recent School Finance Litigation and Legislative Action

In 2016, the Texas Supreme Court decided *Morath v. The Texas Taxpayer and Student Fairness Coalition*[5], a lawsuit filed by more than 600 districts challenging the constitutionality of the Texas school finance system. The Court 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."

In response to this decision and failed attempts in 2017 to update the school finance system, the legislature convened a commission tasked with recommending targeted changes to update the school finance system before the 86th Legislative Session in 2019. Composed of legislators from the Senate and House, appointees from the business community, and school business officials, the Texas Commission on Public School Finance unanimously approved a report with over 30 recommendations on school finance updates ranging from compensatory education to new allotments for fast growth schools and dyslexia.

With support from the governor, lieutenant governor and speaker of the house, the legislature accepted several of the commission's recommendations when it passed House Bill 3 in 2019. HB 3, among many of its changes, updated the compensatory education allotment to a sliding scale based on density of poverty, created a new bilingual education program, instituted a new early education allotment, and increased the basic allotment from $5,140 to $6,160. Additionally, HB 3 eliminated other programs like the cost of education index and the high school allotment.

While many of the changes in HB 3 were monumental for a state that had not substantially changed the school finance system for decades, the state now faces new challenges because of COVID-19 and loss in revenue from decreased oil prices. Finding the resources to maintain the ground gained under HB 3 will be challenging as the state looks toward the 87th Legislative Session in 2021.

Conclusion

State government and local school districts share responsibility for funding Texas public schools. Legislators have 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.

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5 *Morath v. The Tex. Taxpayer & Student Fairness Coal.*, 490 S.W.3d 826 (Tex. 2016).

This document is continually updated, and references to online resources are hyperlinked, at tasb.org/services/legal-services/tasb-school-law-esource/business/documents/texas-school-finance-system-overview.pdf. For more information on this and other school law topics, visit TASB School Law eSource at schoollawesource.tasb.org.

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