

TEXAS PUBLIC SCHOOL FINANCE SYSTEM

General

To limit disparities in school district funding abilities, the public school finance system (1) compels districts with taxable property wealth per weighted student higher than \$300,000 in the 2001 - 2002 school year or \$305,000 in the 2002 - 2003 school year to reduce their wealth to the amount applicable for such year or to divert a portion of their tax revenues to other districts as described below and (2) provides various State funding allotments, including a basic funding allotment and other allotments for "enrichment" of the basic program, for debt service tax assistance and for new facilities construction.

State Funding for Local School Districts

The current public school finance system provides for (1) State guaranteed basic funding allotments per student ("Tier One") and (2) State guaranteed revenues per student per penny of local tax effort to provide operational funding for an "enriched" educational program ("Tier Two"). Tier One and Tier Two are generally referred to as the Foundation School Program. In addition, the system includes, among other funding allotments, an allotment to subsidize existing debt service up to certain limits ("Tier Three"), the Instructional Facilities Allotment (the "IFA"), and an allotment to pay operational expenses associated with the opening of a new instructional facility. State funding allotments may be altered and adjusted to penalize school districts with high administrative costs and, in certain circumstances, to account for shortages in State appropriations or to allocate available funds in accordance with wealth equalization goals.

Tier One allotments are intended to provide a basic program of education rated academically acceptable and meeting other applicable legal standards. If needed, the State will subsidize local tax receipts to produce a basic allotment of \$2,537 per student in average daily attendance. To receive the State subsidy, a school district must levy an effective property tax of at least \$0.86 per \$100 of assessed valuation.

Tier Two allotments are intended to guarantee each school district an opportunity to provide a basic program and to supplement that program at a level of its own choice, however Tier Two allotments may not be used for the payment of debt service or capital outlay. Each school district is guaranteed a specified amount per weighted student in State and local funds for each cent of tax effort (excluding the District's bond debt service tax effort) that a school district levies above the effective rate of \$0.86 required for its Tier One local share, not to exceed \$0.64 per \$100 of assessed valuation. The guaranteed specified amount per weighted student in State and local funds for each cent of tax effort (the Tier Two allotment) was increased by the 77th Legislature, from \$24.99 to \$25.81 for 2001 - 2002 and to \$27.14 for 2002 - 2003, in part to fund the costs of the school district health care system described below. The State's share of the school district health care system, effective September 1, 2002, is funded, in general terms by a dedication of 75% of the additional funds to which a school district is entitled due to the increase in the equalized wealth level or the Tier Two allotment.

The IFA became effective September 1, 1997. The IFA guarantees each school district a specified amount per student (\$35) in State and local funds for each cent of tax effort to pay principal of and interest on eligible bonds issued to construct, acquire, renovate or improve instructional facilities. To receive an IFA, a school district must apply to the Commissioner in accordance with rules adopted by the Commissioner before issuing the bonds to be paid with State assistance. The total amount of debt service assistance over a biennium for which a district may be awarded is limited to the lesser of (1) the actual debt service payments made by the district in the biennium in which the bonds are issued; or (2) the greater of (a) \$100,000 or (b) \$250 multiplied by the number of students in average daily attendance. The IFA is also available for lease purchase agreements and refunding bonds meeting certain prescribed

conditions. If the total amount appropriated by the State for IFA in a year is less than the amount of money school districts applying for IFA are entitled to for that year, districts applying will be ranked by the Commissioner by wealth per student, and State assistance will be awarded to applying districts in ascending order of adjusted wealth per student beginning with the district with the lowest adjusted wealth per student. In determining wealth per student for purposes of the IFA, adjustments are made to reduce wealth for certain fast growing districts. Once a district receives an IFA award for bonds, it is entitled to continue receiving State assistance without reapplying to the Commissioner and the guaranteed level of State and local funds per student per cent of tax effort applicable to the bonds may not be reduced below the level provided for the year in which the bonds were issued. The Legislature appropriated \$50,000,000 in new money for the IFA program for 2001 - 2002, with an additional \$50,000,000 in new money appropriated for 2002 - 2003 conditioned upon the Commissioner of Education certifying that certain excess funds are available for such purpose.

State financial assistance is provided for certain outstanding debt issued by school districts (referred to herein as Tier Three) to produce a guaranteed yield of \$35.00 in revenue per student per penny of debt service tax levy. The portion of the local debt service rate that may qualify for equalization funding by the State was increased by the 77th Legislature from \$0.12 per \$100 of valuation to \$0.29 per \$100 of valuation for the 2001 - 2002 school year, however, this increase will not apply to the 2002 - 2003 school year unless the Commissioner of Education certifies that certain excess funds are available to fund the equalization cost for local tax effort in excess of \$0.12. The 77th legislature also amended the Tier Three provisions to provide, in general, that a district's bonds are eligible for the allotment if, during the 2000 - 2001 school year, the district (i) made payments on such bonds or (ii) levied and collected debt taxes for the payment of principal and interest on such bonds. Bonds for which a district made payments during the 2000 - 2001 fiscal year but did not levy a tax to make such payment during the 2000 - 2001 fiscal year may be eligible for Tier Three allotments in the 2001 - 2002 and 2002 - 2003 fiscal year under certain limited conditions. A district may not receive Tier Three funding for the principal and interest on a series of otherwise eligible bonds for which the district receives overlapping IFA funding.

A district may also qualify for an allotment for operational expenses associated with opening new instructional facilities. This funding source may not exceed \$25,000,000 in one school year on a State wide basis. For the first school year in which students attend a new instructional facility, a district is entitled to an allotment of \$250 for each student in average daily attendance at the facility. For the second school year in which students attend that facility, a district is entitled to an allotment of \$250 for each additional student in average daily attendance at the facility. The new facility operational expense allotment will be deducted from wealth per student for purposes of calculating a district's Tier Two State funding.

Other State Funding Provisions

A new school district employee health care coverage program was established during the 77th Legislature. Participation in the program is limited to employees who are participants in the Teacher Retirement System of Texas. The Teacher Retirement System of Texas is directed to implement and administer, as trustee, the program and establish plans of group coverages for those participating in the program.

Commencing September 1, 2002, all districts with 500 or fewer employees are required to participate in the program. Districts already covered by contract for insurance are not required to join until such contract expires. Beginning September 1, 2005, any district with more than 500 employees may elect to participate in the program and, under certain circumstances, may elect to participate in the program after September 1, 2002. Subject to formulas that take into account wealth equalization goals, the State will assist participants in the program by annually providing at least \$900 for each covered employee. In

general, the State's share of the cost of the program is financed by the increases in Tier II funding and equalized wealth levels described above. Each district must provide minimum local effort each fiscal year to provide health coverage in an amount equal to the number of participating employees multiplied by \$1,800. For school districts that spent less than \$1,800 per employee per year for health care insurance in 2000-2001, additional State funding assistance will be provided to enable such districts to transition to the minimum local effort of \$1,800 for each participating employee. Transition funding assistance for 2002-2003 will be provided in an amount equal to \$1,800 per employee less the amount the district spent for each covered employee in 2000-2001 (and less any amount by which 75% of the increase in Tier II funding exceeds \$900), with the amount of State transition assistance reduced by \$300 each year thereafter. The \$300 per year reduction in State transition assistance does not apply to districts that levied maintenance taxes at the maximum statutory limit (for most districts, \$1.50 per \$100 of taxable assessed valuation) during the 2000 - 2001 fiscal year. The rollback tax rate calculation for school districts that receive such additional State funding has been revised to include in the rollback tax rate the tax rate necessary for the school district to generate local tax revenues sufficient to offset the \$300 per year reduction in State funding.

Legislation known as the Texas Economic Development Act, which provides incentives for certain school districts to grant tax abatements to encourage development in their tax base, was enacted during the 77th Legislature. A school district is permitted to grant an application for a limitation on appraised value of certain "eligible property" owned by a corporation or limited liability company and used in connection with manufacturing, research and development or renewable energy electric generation, if a statutory minimum investment was reached (calculated based on the size of the school district's tax base). The limitation on appraised value would last for up to ten years and would only apply to taxes levied for maintenance and operations purposes. The Act amends the Texas Education Code to provide additional State funding for each year of a qualifying tax abatement agreement in the amount of the tax credit provided to the taxpayer by the district.

Other legislation was enacted during the 77th Legislature that requires the Commissioner of Education to develop and implement a financial accountability rating system for school districts, and as part of the system, develop a procedure for each school district to prepare and distribute an annual financial management report and to hold a public hearing on the report. A transitional financial accountability rating system is to be implemented by September 1, 2002, with full implementation by September 1, 2003.

Local Revenue Sources B Property Tax Authority

Under the current school finance system, the primary source of local funding for school districts is ad valorem taxes levied against the local tax base. Current law authorizes school districts, subject to voter approval, to levy an annual ad valorem tax for maintenance and operations of the district at a rate, subject to limited exceptions, not to exceed \$1.50 per \$100 assessed valuation and to levy a bond debt service tax that may be unlimited in rate. Many school districts, however, voted their maintenance tax under prior law and may be subject to other limitations on this tax rate. See "TAX RATE LIMITATIONS" herein. Each year in setting the annual tax rate, the governing body of a school district cannot adopt a tax rate exceeding the district's "rollback tax rate" without submitting such tax rate to the voters at a referendum election. See "TAX RATE LIMITATIONS B Rollback Tax Rate and Election" herein.

Wealth Transfer Provisions

Under the public school finance system, districts are required to effectively adjust taxable property wealth per weighted student ("wealth per student") for each school year to no greater than \$300,000 in 2001 - 2002 or \$305,000 in 2002 - 2003 (the "equalized wealth level"). A district's wealth per student for any

school year is the taxable value of property in the district in the prior tax year, as adjusted by the Texas Comptroller of Public Accounts for statewide disparities in assessment, divided by the Texas Education Agency's most recent projection of the district's weighted students during such school year. A district may effectively reduce its wealth per student either by reducing the amount of taxable property within the district relative to the number of weighted students, by transferring revenue out of the district or by exercising any combination of these remedies.

A district has four options to reduce its wealth per student so that it does not exceed the equalized wealth level.

First, a district may consolidate by agreement with one or more districts to form a consolidated district. All property and debt of the consolidating districts vest in the consolidated district. After a transition of up to one year the consolidated district is governed by a single board of trustees.

Second, a district may consolidate by agreement with one or more districts to form a consolidated taxing district solely to levy and distribute either maintenance and operation taxes or both maintenance and operation taxes and debt service taxes. Consolidation for these limited purposes must be approved by each consolidating district's qualified voters. If a consolidated taxing district is formed to fund both maintenance and operation and debt expenses, it may assume the outstanding indebtedness of the component districts (if provided in the agreement), may issue bonds as if it were an independent school district and may levy taxes to pay all such bonds. If a consolidated taxing district is formed for this broader purpose, no component district may levy bond taxes except to pay unassumed obligations issued before creation of the consolidated taxing district. If districts consolidate solely for maintenance and operations purposes, then indebtedness remains the separate responsibility of the component districts, and they may continue to levy taxes to pay outstanding and subsequently issued debt.

Third, a district may detach property from its territory for annexation by a property poor district. After detachment and annexation, the resulting wealth per student of each district must not be greater than the equalized wealth level and the annexing district must have a resulting yield per student per penny of effective tax that is less than \$25.81 in 2001 - 2002 or \$27.14 in 2002 - 2003. The annexing district must assume the portion, if any, of the detaching district's debt that is fixed by agreement or, absent agreement, is determined to be an equitable portion by the commissioners courts in the counties in which the districts are located.

Fourth, a district may educate students from other districts who transfer to the district without charging tuition to such students.

A district has three options to transfer tax revenues from its excess property wealth. First, a district with excess wealth per student may purchase "attendance credits" by paying the tax revenues to the State for redistribution under the Foundation School Program. Second, it can contract to disburse the tax revenues to educate students in another district, if the payment does not result in effective wealth per student in the other district to be greater than the equalized wealth level. Both options to transfer property wealth are subject to approving elections by the transferring district's qualified voters. Third, a wealthy district may reduce its wealth by paying tuition to a non-wealthy district for the education of students that reside in the wealthy district.

A district may not adopt a tax rate until its effective wealth per student is the equalized wealth level or less. If a final court decision holds any of the preceding permitted remedial options unlawful, districts may exercise any remaining option under a revised schedule approved by the Commissioner.

If a district fails to exercise a permitted option, the Commissioner must reduce the district's property

wealth per student to the equalized wealth level by detaching mineral, utility, industrial, or commercial property from the district and annexing the property to a property poor district or, if necessary, consolidate the district with a property poor district. To be eligible to annex detached property, the annexing district must have a resulting yield per student per penny of effective tax that is not more than \$25.81 in 2001 - 2002 or \$27.14 in 2002 - 2003. To be subject to consolidation, the district resulting from the consolidation must have an effective wealth per student not greater than the equalized wealth level. Detachment and annexation by the Commissioner must occur by November 8 of each year, and consolidation by the Commissioner must occur as soon after November 8 as practicable. Provisions governing detachment and annexation of taxable property by the Commissioner do not provide for assumption of any of the transferring district's existing debt.

A district may exceed wealth per student of the equalized wealth level if, after detaching property for annexation or purchasing attendance credits, the additional wealth per student is necessary to maintain 1992 1993 State and local revenues per weighted student for maintenance and operation of the district, less the district's current year distribution per weighted student from the Available School Fund. To qualify under such provisions, a school district must impose an effective tax rate for maintenance and operation of the district equal to the greater of the district's current tax rate or \$1.50 on the \$100 valuation of taxable property.

Tax Rate Limitations

A school district is authorized to levy maintenance and operation taxes subject to approval of a proposition submitted to district voters under Section 45.003(d) of the Texas Education Code, as amended. Subject to limited exceptions, the maximum tax rate that may be approved by voters for maintenance and operations is \$1.50 per \$100 of assessed valuation. Many school districts, however, voted their maintenance tax under prior law and may be subject to other limitations on this tax rate.

A school district is also authorized to issue bonds and levy taxes for payment of bonds subject to voter approval of a proposition submitted to the voters under Section 45.003(b)(1), Texas Education Code, as amended, which provides a tax unlimited as to rate or amount for the support school district bonded indebtedness.

Chapter 45 of the Texas Education Code, as amended, requires a district to demonstrate to the Texas Attorney General that it has the prospective ability to pay debt service on a proposed issue of bonds, together with debt service on other outstanding "new debt" of the district, from a tax levied at a rate of \$0.50 per \$100 of assessed valuation before bonds may be issued. In demonstrating the ability to pay debt service at a rate of \$0.50, a district may take into account State allotments to the district which effectively reduce the district's local share of debt service. Once the prospective ability to pay such tax has been shown and the bonds are issued, a district may levy an unlimited tax to pay debt service. Taxes levied to pay debt service on bonds approved by district voters at an election held on or before April 1, 1991 and issued before September 1, 1992 (or debt issued to refund such bonds) are not subject to the foregoing threshold tax rate test. The Bonds are "new debt" and are subject to the \$0.50 threshold tax rate test. Effective September 1, 2001, a district may demonstrate its ability to comply with the \$0.50 threshold tax rate test by applying the \$0.50 tax rate to an amount equal to 90% of projected future taxable value of property in the district, as certified by a registered professional appraiser, anticipated for the earlier of the tax year five years after the current tax year or the tax year in which the final payment for the bonds is due. However, if a district uses projected future taxable values to meet the \$0.50 threshold tax rate test and subsequently imposes a tax a tax rate greater than \$0.50 per \$100 of valuation to pay for bonds subject to the test, then for subsequent bond issues, the Attorney General must find that the district has the projected ability to pay principal and interest on the proposed bonds and all previously issued bonds subject to the \$0.50 threshold tax rate test from a tax rate of \$0.45 per \$100 of valuation.

Rollback Tax Rate

In setting its annual tax rate, the governing body of a school district generally cannot adopt a tax rate exceeding the district's "rollback tax rate" without approval by a majority of the voters voting at an election approving the higher rate. The rollback tax rate is the sum of (1) the tax rate that, applied to the current tax values, would provide local maintenance and operating funds, when added to Tier One and Tier Two state funds to be distributed to the district for the school year beginning in the current tax year, in the same amount as would have been available to the district in the preceding year if the funding elements of wealth equalization and state funding for the current year had been in effect for the preceding year, (2) the rate of \$0.06; and (3) the district's current debt rate. For tax years 2003 through 2008, the rollback tax rate will also include the tax rate that, applied to current tax values, would impose taxes in an amount sufficient for the district to fund its minimum local effort requirement for employee health care coverage.