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Budget Information Brief / 2005-5

Overview of the 2005-07 K-12 Budget

The Oregon Constitution directs the Legislature to “provide by law for the establishment of a uniform and general system of common schools.” General state support for K-12 schools and education service districts (ESDs) is provided through the State School Fund. The Department of Education (ODE) makes distributions of state support to districts that meet all legal requirements (ORS Chapter 327).

Allocations to school districts include a transportation grant, a facility grant, and a general-purpose grant. The general-purpose grant follows a legislatively prescribed distribution formula based on number of students, additional weighting reflecting specific greater education costs, teacher experience, and local tax resources. This formula was designed to equalize allocations to schools. It was phased in over time through the use of flat and stop-loss grants designed to ease the transition for certain school districts. Full implementation of the equalization formula occurred in the 2001-03 biennium. The 2001 Legislature adopted a phase-in plan to equalize ESD funding. Final equalization for ESDs begins in 2005-06.

Each regular legislative session, the Legislature typically approves modifications to the distribution formula. Changes made by the 2005 Legislature can be found in HB 2450. These changes include the extension of a high-cost disability grant as part of the school equalization formula and continuation of a small school district supplement fund.

Currently, there are 199 elementary and secondary school districts and 20 education service districts, serving about 550,000 students in grades K-12. Over the ten-year period from 1992-93 to 2002-03, enrollment increased by 8.6%. In 2003-04, enrollment dropped by 0.5%, reportedly the first decrease since 1984-85. Enrollment is expected to increase slightly in 2005-07.

There has been a significant change in student demographics over the last decade. In its *2003-04 Statewide Report Card*, ODE illustrates this change.

- The proportion of minority enrollment to total enrollment has increased from 12.5 % in 1992-93 to 25% in 2003-04.
- The number of students for whom English is not the primary language has increased substantially, from 2.4% of all students in 1992-93 to 11% in 2003-04. These students speak at least one of about 138 different languages other than English. The most common second language is Spanish, with about 44,000 students speaking it.
- The low-income population in public schools (as indicated by the number of free and reduced-price lunches) was about 41% of all students in 2003-04, up from 31% in 1995-96.
- Students needing special education services made up about 13% of the total of all students in 2003-04, up from 10.8% in 1992-93.

These changes have implications in how education is provided locally, ranging from the necessity for English as a Second Language services to culturally-sensitive programs needed to reduce the higher drop-out rate among minority students.

Voter approval of Measure 5 in 1990 and Measure 50 in 1997, both of which limited local property tax revenues, caused a significant shift in funding sources for K-12 education. The proportion of state support for K-12 education has increased from about 28% in 1990-91 to about 66% in 2004-05. As this

shift in funding has occurred, there has been more focus on how to balance local control of expenditures with accountability to the Legislature, the taxpaying public, and others. High academic standards, student assessments, school and district report cards, public access to schools' financial information through a database maintained by ODE, and other efforts are steps towards accountability.

The federal No Child Left Behind Act (NCLB) reinforces and adds to accountability requirements for the school districts and individual schools. Annual student assessments aligned with state standards are the primary measure of accountability. Schools are responsible for ensuring students make adequate yearly progress (AYP), as defined by the state. There are consequences for failure to make progress, such as allowing students to transfer to another school. For the 2004-05 school year, about 32.4% of schools in Oregon failed to meet AYP. Title 1 schools (about one-quarter of the AYP-deficient schools) are eligible for federal school improvement funds. Although the U.S. Congress appropriated additional federal funding to implement NCLB requirements, states have expressed serious concerns that the funding may be inadequate to carry out the federal mandates.

State Funding Sources for the State School Fund

The following chart shows state funding levels and sources of funds for the State School Fund and certain targeted K-12 grants for three biennia (including the Governor's 2005-07 recommended budget). Amounts shown for 2001-03 reflect special session adjustments, which are discussed in the following section of this document.

	2001-03 Actual	2003-05 Legislatively Approved *	2005-07 Governor's Recommended	2005-07 Legislatively Adopted
General Fund	3,802,109,714	4,462,368,481	4,703,817,141	4,834,392,341
Lottery Funds	614,555,682	452,100,536	295,732,859	405,057,659
Other Funds	267,626,128	17,191,710	950,000	950,000
Total Funds	\$4,684,291,524	\$4,931,660,727	\$5,000,500,000	\$5,240,400,000

** The 2003-05 Legislatively Approved Budget includes \$14.3 million Other Funds expenditure limitation for the Department of Education to distribute additional property tax revenues to schools. These revenues were part of the tax package defeated by voters in February 2004 (Measure 30). The defeat of the measure did not automatically reduce the Other Funds limitation. The actual 2003-05 state funding level is \$4.917 billion rather than \$4.93 billion.*

General Fund represents the primary source of support for the State School Fund.

Lottery Funds in 2001-03 included \$262 million in transfers from the Education Stability Fund (ESF) and \$353 million of net unobligated lottery resources. The 2003-05 legislatively approved budget includes a \$122 million transfer from the Education Stability Fund in May 2005 (HB 3642) as well as net unobligated lottery resources of \$330 million. The Governor's 2005-07 budget included net unobligated lottery resources of \$295.7 million, including \$4.4 million to be generated from the addition of line games to the selections currently offered to players of video lottery games.

For 2001-03, the majority of Other Funds were from Medicaid Upper Payment Limit resources (\$242 million). The balance of \$26 million was primarily from state timber taxes. In 2003-05, state timber tax revenues are estimated to be \$2.9 million. Of the total \$17.2 million Other Funds expenditure limitation for 2003-05 shown in the table above, \$14.3 million was for distribution of additional property taxes to schools. These revenues were to have come from a reduction in the discount for early payment of property taxes, but they were part of the tax package defeated by voters in February 2004. In the Governor's budget, Other Funds revenues are from state timber taxes.

Recent State School Fund History

In recent years, state funding for Oregon schools has experienced a great degree of instability. The 2001-03 legislatively adopted budget for the State School Fund was \$5.2 billion, but legislative actions taken in 2002 to rebalance the statewide General Fund budget resulted in reductions of about \$500 million from the adopted budget. The Legislature attempted to mitigate \$211 million of these reductions by passing legislation enabling school districts to implement an accounting practice (the "accrual provision") that effectively uses part of a given year's state funding to pay expenditures of the previous year. Anecdotal

reports indicated that about one-half of districts used this provision. Had all districts used it, total state support would have been at approximately \$4.9 billion, about \$100 million over the 1999-2001 level. In response to these budget reductions, with most affecting the 2002-03 school year, school districts reported staff layoffs and reductions in the number of school days. In Spring 2003, 90 school districts reported they were cutting days due to budget reductions. Although the average number of days cut was five, some districts, such as Hillsboro at 17 days, were much higher than the average. About one-third of those districts reporting fewer school days indicated they would be below the minimum number of hours required in Oregon.

In 2003, the Legislature adopted a State School Fund budget of \$5.2 billion, essentially the same as that approved by the 2001 Legislature prior to special session reductions. To potentially reach a K-12 funding level of \$5.3 billion, the 2003 Legislature provided that the State School Fund could receive additional funding if economic recovery occurred in 2003-05. As long as the state's 2003-05 General Fund ending balance was at least \$100 million as of the June 2004 revenue forecast, the State School Fund was eligible to receive 50% of any excess over the \$100 million ending balance, until state support of the State School Fund reached a total of \$5.3 billion.

While schools did receive \$8.3 million under these provisions, the State School Fund was reduced by \$298.9 million due to the defeat of Measure 30 by voters in February 2004. Thus, the 2003-05 state support dropped to \$4.92 billion. Offsetting the state reductions to a slight degree were increased Common School Fund distributions of \$26 million and a \$50 million increase in other local revenues.

The effects of last biennium's reductions depended upon an individual school district's circumstances. Districts had more time to plan for reduced state support in 2003-05, unlike 2001-03, and many reported implementing the reductions over two years to avoid drastic program cuts in 2004-05. However, for a variety of reasons, many districts had difficulty in maintaining program levels. Budget reductions have come on top of declining enrollment, depleted financial reserves, and/or higher program costs. Districts reported staff layoffs, reductions in course offerings, and increased class sizes resulting from last biennium's state budget reductions. Certain districts have been able to pass local revenue measures to help mitigate some of the effects of these reductions.

2005-07 Legislatively Adopted Budget

The 2005-07 legislatively adopted budget provides \$5.24 billion in state support for K-12 school funding. This is an increase of about \$323 million, or 6.6%, above the 2003-05 legislatively approved budget of \$4.92 billion. General Fund is increased by \$372 million, but about \$50 million of this increase is due to a shift from Lottery and Other Funds to General Fund support in 2005-07. The legislatively adopted budget does not rely on one-time funding sources.

Of the total \$5.24 billion budget, \$4.834 billion is from General Fund support, \$405.1 million is from lottery support, and \$950,000 from state timber taxes (expended as Other Funds). The budget provides \$2.567 billion for schools and education service districts in 2005-06 and \$2.673 billion in 2006-07.

To potentially reach a K-12 funding level of \$5.263 billion, the Legislature provided that the State School Fund would receive additional funding if General Fund revenues increase over the close-of-session economic and revenue forecast for 2005-07. If General Fund growth occurs as of the June 2006 forecast for 2005-07, then the State School Fund is eligible to receive an additional amount of up to \$23 million for the 2006-07 school year.

The budget includes \$400,000 General Fund for local option matching grants to eligible districts that have passed local option levies. An additional \$800,000 is appropriated to the Emergency Board for these grants. The Legislature directed the Department of Education to report with updated data on eligible districts when requesting allocation of the special purpose appropriation.

The essential budget level for the State School Fund is determined each interim by the School Revenue Forecast Committee, which was established by executive order in 1999. Assumptions made by the Committee for the 2005-07 essential budget level include, among other factors, a 15.09% Public Employees Retirement System (PERS) rate; increases of 12% annually in health benefits costs; about a 2%

annual increase in teacher salaries; and growth in student counts of 0.31% for 2005-06 and 0.48% for 2006-07. Going into the 2005 session, the essential budget level was calculated at \$5.318 billion.

During the 2005 legislative session, the budget committees discussed an anticipated increase in the estimated PERS employer contribution rate for schools in 2005-07 – from 15.09% to 15.72%; a possible decrease in the rate of growth in health benefits costs for the first year – from 12% to 8%; and a \$50 million increase over previous estimates for local revenues in 2005-07, primarily due to growth in estimated Common School Fund distributions for K-12 schools. Had these assumptions been used by the School Revenue Forecast Committee, the essential budget level would be closer to \$5.258 billion. However, the Committee does not typically meet during legislative sessions to update or refine its calculation. And, regardless of the assumptions used, decisions involving collective bargaining agreements and school budgets are made at the local level and likely will differ (up or down) from some of these statewide assumptions.

During 2005-07, districts will receive an estimated \$247 million increase in local revenues, which are primarily property taxes. Thus, combined state and local support increases by 7.8% from 2003-05 to 2005-07 (from \$7.261 billion to \$7.83 billion). The statewide average for per-student (weighted) spending in 2005-06 is estimated to be approximately \$5,472.

Common School Fund Distributions

Beginning in 2005-06, ODE will distribute transfers from the Common School Fund to K-12 school districts. Previously, the Department of State Lands distributed these monies to county treasurers, who in turn made payments to school districts. HB 3183 (2005) made the Superintendent of Public Instruction responsible for making these distributions to the districts. The distribution policy adopted by the State Land Board is based on a sliding scale for annual distributions between 2% and 5% of the Common School Fund market value as of December 31st of each year. The percentage of distribution is based on the annual growth rate in the Common School Fund's market value. The policy took effect with the 1999-2000 school year.

Distributions have fluctuated over the past several biennia. The total distribution of \$48 million for 2001-03 was far below the 1999-2001 distribution of \$76 million, due to declines in the stock market as well as lower earnings. On the other hand, distributions in 2003-05 were \$53.5 million, a \$26.4 million increase over the amount originally anticipated by the 2003 Legislature. This large increase was due to a rebound of the market.

Common School Fund distributions by the Department of State Lands are anticipated to be \$89.9 million in 2005-07, an increase for K-12 schools of about \$36 million over the 2003-05 amount of \$54 million. The wide disparities among recent distributions are illustrative of the effect of market conditions on distributions from the Fund. To prevent such large variations in distributions in the future, the State Land Board voted to switch to a three-year rolling average for calculating the Fund's value after January 1, 2006.

Historical Trend in Support for K-12 Education

The table on the following page shows the trend in support for K-12 education since 1990-91. The table does not include federal or local resources not subject to the distribution formula. Local resources do include Common School Fund distributions to schools by the Department of State Lands. The Department's 2005-07 legislatively adopted budget includes \$89.9 million Nonlimited Other Funds for this purpose. The table also includes certain targeted state support, as noted in the footnotes.

K-12 Support: 1990-91 through 2006-07

(\$ in millions)											
Fiscal Year	State funding (a)	Local funding	Total	Percent change	State share	Fiscal Year	State funding (a)	Local funding	Total	Percent change	State share
1990-91	626	1598	2224	-	28%	1999-2000	2326 (d)	967	3293	4.9%	71%
1991-92	818	1561	2379	7.0%	34%	2000-01	2437 (d)	995	3432	4.2%	71%
1992-93	1100	1490	2590	8.9%	42%	2001-02	2537 (e)	1040	3577	4.2%	71%
1993-94	1132	1343	2475	-4.4%	46%	2002-03	2358 (f)	1112	3470	-3.0%	68%
1994-95	1427	1178	2605	5.3%	55%	2003-04 Est	2591	1134	3725	7.3%	70%
1995-96	1750	902	2652	1.8%	66%	2004-05 Est	2326 (g)	1210	3536	-5.1%	66%
1996-97	1760	956	2716	2.4%	65%	2005-06 LAB	2566	1273	3839	8.6%	67%
1997-98	2078 (b)	896	2974	9.5%	70%	2006-07 LAB	2673	1318	3991	4.0%	67%
1998-99	2250 (c)	889	3139	5.5%	72%						

a State funding includes juvenile corrections for 1992-93 through 2003-05; Common School Fund distributions are reflected as local revenues

b Includes one-time funding of \$50 million for classroom needs and \$5 million for security; reflects reduction for \$26 million excess property taxes over cap

c Includes \$150 million from lottery bond sale for school facilities

d Includes \$127 million lottery bond proceeds, \$50 million in SB 622 proceeds, and \$4 million General Fund to schools with more than 50,000 ADMw; assumed distribution: \$83 million in 1999-00, \$98 million in 2000-01

e Includes \$108 million School Improvement Fund and \$225,000 for local option matching grants

f Includes \$225,000 for local option matching grants; includes potential accrual of \$211 million by school districts from 2003-05 resources (SB 1022 – 2002 Third Special Session); without the accrual, the percentage change from 2001-02 is -9.4%; reflects failure of Measure 28 (\$95 million) and \$46 million allotment reduction

g Includes \$8.3 million generated under legislatively adopted trigger language; reflects failure of Measure 30 in 2004-05 per HB 5077; both 2003-04 and 2004-05 include state funding for local option matching grants (biennial total of \$400,000)

Source: Legislative Revenue Office & Legislative Fiscal Office; historical data adjusted to actual and comparable funding sources

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