



2005 SCHOOL FINANCE LEGISLATION

Funding and Distribution

RESEARCH REPORT # 3-05

October 2005

Legislative Revenue Office

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STATE OF OREGON

Research Report

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INTRODUCTION

This report describes legislation affecting Oregon's school finance system that the Legislature passed in the 2005 regular session. The school finance system funds K-12 school districts and Education Service Districts (ESDs). State support of school districts and ESDs is primarily funded through the State School Fund, but also includes other funds.

School finance legislation in the 2005 regular session focused on three major issues: the level of state school funding, continuing the equalization of high cost special education expenses and the funding and structure of ESDs. The Legislature adopted a school finance package of \$5.24 billion with the potential of \$23 million more. This is more than the Governor's budget initially proposed. The Legislature maintained a high cost disability grant in the school equalization formula and modified the facility grant component. Another issue was additional funding for small high schools. Small districts with small high schools continued extra funding per high school student. Other attempts to change the K-12 equalization formula to benefit rural, declining enrollment and high growth districts were unsuccessful.

The 2005 legislation is a continuation of incremental changes to the state's school finance system that was adopted in 1991 after voters passed Ballot Measure 5 in 1990. State funding was less than 30% of school general operating revenue in 1990-91, but increased to about 70% in 1997-98 and has remained at almost this level since then.

The first section of this report summarizes state appropriations and local revenue estimates for the 2005-07 biennium. The second section describes changes to the school equalization formula and other funding changes. The last section has a brief description of the changed formula as it now applies to the 2005-07 allocation of state school funds. The ESD allocation is also briefly reviewed.

K-12 AND ESD FUNDING

State School Fund Appropriation

The 2005 Legislature appropriated \$5.24 billion to the State School Fund (SSF) for state aid to both K-12 school districts and Education Service Districts (ESDs). This is about 43% of budgeted General Fund and lottery expenditures. The biennial appropriation is in SB 5510. The table summarizes the results of this bill. The General Fund portion is 92.3% of the total and

State School Fund Sources			
	2005-06	2006-07	Biennium
General Fund	\$.	\$.	\$4,834.0
Lottery			405.1
Private Timber	—	—	<u>0.9</u>
Total	2,566.6	2,673.4	5,240.0
Percent Increase	10.3%	4.2%	6.6%
GF Trigger Limit	<u>0</u>	<u>23.0</u>	<u>23.0</u>
Total with Trigger	2,566.6	2,696.4	5,263.0
Percent with Trigger	10.3%	5.1%	7.1%
Dollars in millions			

lottery funds 7.7%. The appropriation for 2005-07 grew by 6.6%. This is after adjusting the 2003-05 close of regular session adopted budget for a subsequent disappropriation due to voter rejection of a temporary income tax increase. The percentage growth comparison is also after increasing the 2004-05 State School Fund appropriation by \$8.3 million for meeting a General Fund growth trigger and by \$1.1 million adopted by the 2005 Legislature in HB5162. Without this additional \$9.4 million the 2005-07 growth rate would be 6.8%.

The total State School Fund expenditure is set for each year of the biennium, but the General Fund and lottery appropriations are for the whole biennium. The annual split for the General Fund and lottery is not specified in the appropriation legislation. This is a change from prior practice. The reason is to allow some flexibility between General Fund and lottery revenue. In each year of the biennium, if one source is above estimate and the other below, then some substitution can take place as long as the biennial total for that source is not exceeded and the annual combination of sources is not exceeded.

An additional \$23 million from the General Fund in 2006-07 is subject to a trigger. The trigger is the size of the June 2006 General Fund revenue forecast. If the June 2006 General Fund revenue estimate for the biennium is more than the end-of-session estimate that includes legislative changes, then the difference up to \$23 million is appropriated to the State School Fund. If the trigger condition is met, the State School Fund growth rate for the biennium is 7.1% or ½% higher.

State School Fund Allocation

The State School Fund is divided up into five separate programs. The adjoining table shows the estimated 2005-07 allocations. The allocations depend on local revenue estimates. The accuracy of local revenue estimates may shift state funds slightly between ESDs and school

districts. The ESD share is 4.4% and the school district share is 95.2%. K-12 and ESD local revenue is in addition to the state funds shown here.

The school district and ESD equalization methods are described later.

Virtual School District

SB1071 creates an Oregon Virtual School District within the Department of Education. The purpose is to provide online courses for public school students in grades K-12. Courses must meet statutory academic content standards and State Board of Education criteria. The virtual district is exempt from statutes and rules

applicable to other school districts unless specifically included. The Superintendent can contract for online courses from various public sources. The State Board can adopt rules and specify criteria for online course selection and qualifications for student access. Public charter schools that offer online courses must have 50% or more of their students reside in the school district where the charter school is located.

The legislation establishes the Oregon Virtual School District Fund and transfers \$2 million to the fund from the State School Fund for the 2005-07 biennium. The virtual district is not eligible for school formula revenue from the State School Fund.

The Department of Education must make a progress report to the interim education committees prior to September 1, 2006 and to the 2007 Legislature prior to March 1, 2007.

Small High Schools

HB2450 maintains the Small School District Supplement Fund and transfers \$5 million (\$2.5 million per year) from the State School Fund to the Small School Fund in 2005-07. This is a continuation of the 2003-05 supplement fund of \$5 million which sunset. Small school districts are districts under 8,500 weighted students with high schools having less than 350 students for 4 grades and 267 for three grades. Ninety-nine school districts will qualify and gain about \$170 per small high school student in 2005-06.

Each small school district receives the same dollar amount per high school ADM (average daily membership) each year of the biennium. The \$2.5 million per year is divided by the sum of the qualified small high school ADM in small districts. This statewide amount per ADM is then multiplied by the small district's number of small high school ADM for a district total. This is the same as allocating the funds based on each district's proportional share of qualified ADM.

State Special Education

The Department of Education provides schooling for certain special education students (ORS 343.243). These students are in hospitals, long-term care facilities or state schools for the deaf

State School Fund Allocation			
	2005-06	2006-07	Biennium
K-12 School			
Virtual School (SB1071)	\$ 1.0	\$ 1.0	\$ 2.0
Small High Schools	2.5	2.5	5.0
State Special Education	9.0	9.5	18.5
School Equalization Formula	2,440.4	2,552.8	4,993.2
ESD			
Equalization Allocation	113.7	107.6	221.3
Total	2,566.6	2,673.4	5,240.0
Dollars in millions; K-12 includes youth corrections and juvenile detention education programs.			

and blind. The Department can bill the State School Fund the average operating costs per student statewide for each of these students. The estimated charge is about \$18.5 million for the 2005-07 biennium. The total charge is not limited by statute.

This continues a policy adopted by the 2001 legislature which shifted Department of Education billing for these special education students from the County School Fund to the State School Fund.

Local Formula Revenue

The table shows estimated local funding of K-12 school and ESD operations. Local revenue is the amount from sources included in the equalization formula by statute. Local revenue is still a significant source of funding even with Measure 50 from 1997. Currently it is about 33% of state and local funding.

Local revenue is about 33% of school formula revenue and 42% of ESD revenue. Local revenue stays in the district where collected. However, local revenue is treated as a statewide resource for equalization purposes.

Local Formula Revenue Estimates			
	2005-06	2006-07	Biennium
K-12			
Property Taxes	\$1,086.1	\$1,138.4	\$2,224.5
Other Sources	109.1	98.1	207.2
Total	1,195.2	1,236.5	2,431.7
Percent Increase	5.3%	3.5%	10.7%
ESD			
Property Taxes	77.7	81.4	159.1
Percent Increase	4.3%	4.8%	8.5%

Dollars in millions.

In the K-12 equalization formula local revenue is mostly property taxes, including taxes paid for prior years, but also includes Common School Fund, County School Fund, state managed county timber trust land and other minor sources. Local revenue having a state or county source is local in the sense that the original source is local. The state or counties serve as revenue collectors and make mandatory payments to school districts. The 2005 Legislature made no

changes to K-12 local revenue sources and the amount anticipated from sources did not change significantly with the Common School Fund being one exception.

The major source of ESD local revenue is property taxes collected by districts. The other minor source is revenue from state managed county timber trust land distributed to districts (also known as Chapter 530 revenue). Local revenue here does not include revenue from the sale of contract services to school districts or other ESDs.

County School Fund

The County School Fund includes the additional school revenue Congress granted states as federal timber replacement revenue in the Secure Rural Schools and Community Self-Determination Act of 2000. The estimate for the federal portion of County School Fund revenue is about \$57 million for the biennium. This is about \$10 million lower than for 2003-05. The Act ends in 2006 and continuation by Congress at full funding for 2006-07 is in doubt. SB 486 from

2001 clarified that 25% of federal timber related funds for national forests will be distributed to school districts in the same way as in the past and be included in school local formula revenue.

Common School Fund

The revenue estimate is based on the change in State Land Board distribution policy adopted in early 2005. To avoid substantial variations in distribution from year to year, the Board decided to calculate the growth rate using a three-year rolling average of fund values. This rate then will determine what percent of the average fund value is to be distributed. The distribution percent can vary from 2% to 5% of the average value based on the average value growth rate. A condition is that there are sufficient earnings to make the distribution level. The distribution estimate is about \$90 million for the biennium and is significantly above the \$54 million for the 2003-05 biennium.

State School Fund and Local Revenue

Combined State School Fund and local revenue makes up most of a school's entire general operating revenue. Statewide, this formula revenue for school district operations will be about 7.8% higher in 2005-07 than in the prior biennium. This combined growth rate is above the State School Fund growth rate because of the higher local revenue growth rate.

Because the K-12 and ESD allocation formulas effectively distribute both State School Fund and local funds, the table shows the estimated combined state and local allocations. These combined allocations are based on local revenue estimates as of the close of the 2005 session. The ESD share is 4.9% with the other 95.1% primarily for school districts.

If the General Fund growth trigger is met in the June 2006 forecast, the State School Fund is increased by up to \$23 million in 2006-07. Assuming the full \$23 million addition, school district formula revenue increases by \$21.9 million and ESD revenue by \$1.1 million.

State School Fund And Local Formula Revenue			
	2005-06	2006-07	Biennium
K-12 School			
Virtual School	\$ 1.0	\$ 1.0	\$ 2.0
Small High Schools	2.5	2.5	5.0
State Special Education	9.0	9.5	18.5
School Equalization Formula	3,630.1	3,784.3	7,414.4
Formula Percent Increase	8.4%	4.2%	7.8%
Local Revenue above Formula	5.5	5.0	10.5
ESD			
Equalization Allocation	191.4	189.0	380.4
Allocation Percent Increase	11.9%	-1.3%	9.5%
Total	3,839.5	3,991.3	7,830.8
Dollars in millions. K-12 includes youth corrections and juvenile detention education programs. End of session local revenue estimates.			

Local Revenue Above K-12 Formula

Typically one or two school districts have local revenue above their formula allocation. The amount is initially included as local revenue in the equalization formula. After determining the

equalization level, excess local revenue is excluded from local revenue. The excess is not recaptured for redistribution to other districts and thus not equalized.

Revenue Cap

The 2005 and 2003 Legislatures did not put a cap on formula revenue during each of the last two biennia. The 2001 Legislature capped the allocation from the State School Fund and local revenue each year based on the close of session local revenue estimates. With an overall cap, if local revenue came in above estimates, state aid decreased to keep the combination under the cap. The 2001-03 caps were not exceeded given the impact of economic conditions on revenue.

Additional K-12 School Funding

The Legislature may also make special allocations to K-12 schools outside the State School Fund. The 2005 Legislature did not make a special allocation primarily for improvements to meet quality education goals. The School Improvement Fund has not been used since 2001-02. The Legislature did allocate up to \$1.2 million for equalization of school local option property tax levies. Although the Legislature makes other categorical grants to schools, these two are included here for comparison because in recent biennia they have been part of the school funding package.

School Improvement Fund

The 2005 Legislature like the 2003 Legislature did not make an appropriation to the School Improvement Fund. The 2001 Legislature approved a \$220 million General Fund appropriation to the Department of Education for the School Improvement Fund, but only \$108 million was distributed in 2001-02. The remainder for 2002-03 was rescinded to help rebalance the budget.

Additional K-12 State Funding			
	05-06	06-07	Biennium
School Improvement Fund	\$ 0	\$ 0	\$ 0
Local Option Equalization	—	—	1.2
Total			1.2
Dollars in millions.			

When funds are available, school districts must apply for funds and the Department of Education has to evaluate district progress. Each district's share of funds is its proportionate share of current year extended average daily membership weighted (ADMw). Youth Corrections Education Program and Juvenile Detention Education students are eligible. Districts may transfer a portion of their grant to charter schools within the district.

Local Option Equalization

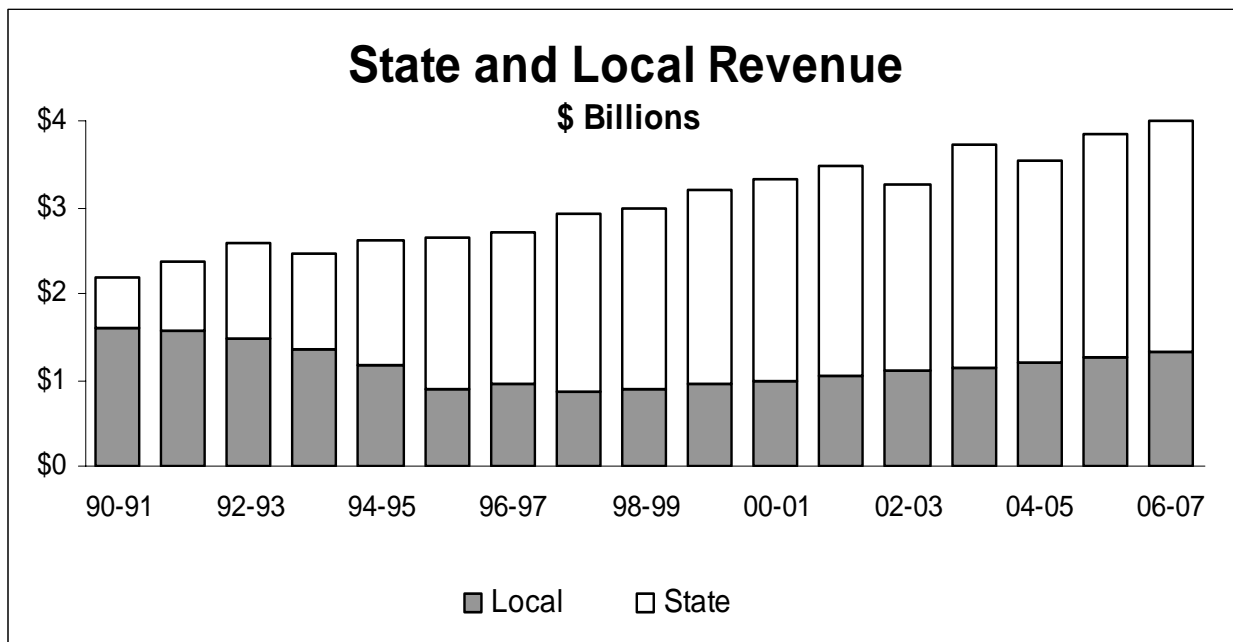
The Legislature appropriated up to \$1.2 million for the equalization of school local option property taxes. Of the total, \$400,000 goes directly to the account and \$800,000 to the Emergency Board. The Board may allocate funds to the account as needed. Only school districts levying a local option property tax may qualify. Local option districts with assessed value per student less than the target district are eligible. The target district assessed value per

student is set so that 25% of the districts are above the target and 75% are at or below the target.

The district equalization grant provides funding as though the district has assessed value per student at the target level. The grant is equal to the number of students times the local option tax rate times the difference between the target value per student and the district assessed value per student. The grant calculation uses prior year tax data. If voters approve a local option during a biennium, the eligible district does not receive a grant payment until the succeeding biennium. Grants are proportionally reduced if appropriated funds are insufficient. Estimated grants are paid by March 31 each fiscal year with subsequent corrections as needed.

Recent Funding History

The chart shows combined state and local formula revenue of school districts and education service districts since 1990-91. Note that the data for the last three years are estimates and that the early years are adjusted to be historically comparable as school finance legislation changed. The chart is not adjusted for inflation or student growth.



In 1990 voters approved Ballot Measure 5 that altered the state-local finance structure. Measure 5 phased in property tax limits that substantially reduced local property taxes for schools. Consequently the 1991 Legislature increased state funding and passed a new school equalization formula. By the end of the 5 year tax limit phase-in, the state primarily funded the school system and virtually eliminated local control over school funding levels.

Voter approval of Measure 50 during the 1997 Legislative Session continued the shift to state funding. Measure 50 (a rewrite of Measure 47 passed just prior to the Session) added another property tax limit more restrictive than Measure 5. In response, the 1997 Legislature raised the level of state funding even higher and further modified the school equalization formula. State

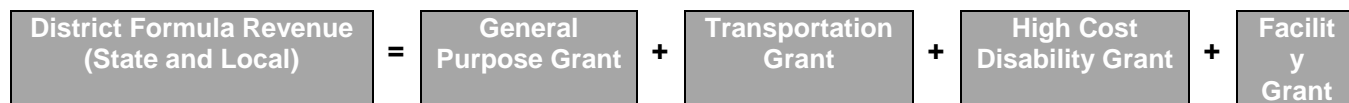
funding, less than 30% of school general operating revenue in 1990-91, increased to about 70% in 1997-98. It has remained at about this level since then except for 2002-03 and 2004-05.

The chart demonstrates how Oregon has moved to a state-funded school system. Measure 5 and Measure 50 property tax cuts reduced the local share by more than half. A dramatic increase in state school aid over this period accomplished a shift to primarily state funding. In 1989-91, 25% of General Fund and lottery expenditures went to K-12 schools and ESDs. In 2003-05, this share is about 44%. Additional State School Fund dollars came from the Education Stability Fund in 2003-05.

K-12 School and ESD Allocation

K-12 School Equalization Formula

School district state and local formula revenue continues to be the sum of four individual grants instead of three. The 2005 Legislature made two changes to the school distribution formula. The Legislature continued the high cost disability grant with a higher threshold. It also increased the facility grant beginning in 2007-08. These changes are in HB 2450.



If the high cost disability grant had sunset, these grant funds would have become part of the general purpose grant. Likewise, beginning in 2007-08, the increased facility grant will reduce the funds available for the general purpose grant. The general purpose grant is the equalizer that makes the sum of the four grants equal available state and local formula revenue.

High Cost Disability Grant

During the 2001 interim a task force studied special education. One of the task force's recommendations was to provide a grant to districts with students requiring special education services that were very costly. High cost special education students tend to be concentrated in urban areas where medical and therapeutic services are available. Thus the number of students is not proportional among districts and the cost for their education can be very disproportional to the revenue generated from the double weighting of these students in the school equalization formula. This was viewed as an extra burden not fairly shared by all districts.

The solution adopted by the 2003 Legislature was to set a cap on the costs paid by the districts that were not taken into account by the existing formula. Districts would continue to receive formula revenue based on a double weight and have to pay costs exceeding that revenue up to \$25,000 per special education student. Costs in excess of \$25,000 were eligible for reimbursement. The analogy was an insurance policy where all districts should pay and a few collect. The Legislature decided to cap high cost disability grants at \$12 million per year. If eligible costs exceed \$12 million, the grants are proportionally reduced to total \$12 million.

The 2005 Legislature chose to increase the student cost threshold for a high cost student to be eligible. Legislation increased the initial \$25,000 threshold to \$30,000. This reduces the expected number of eligible students by about half. The total grant continues to be limited to \$12 million. The result is that the percent of eligible costs covered by the grant should increase from about 70% to near 100%.

High Cost Disability Grant	=	Up to Sum of Costs above \$30,000 per Disability Student
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A district's high cost disability grant is the sum of the approved disability costs for each special education student that exceeds \$30,000 per year. The school district can add ESD special education costs incurred for the same student for the student's total special education cost.

Keeping a high cost disability grant in the formula reduces the general purpose grant total by the same \$12 million. Thus all districts share in the cost and those with high cost disabilities benefit when their high cost disability grant exceeds the reduction in their general purpose grant.

Facility Grant

The cost of new facilities to increase classroom space is a differentiating cost factor for districts with new classrooms to equip. Districts with rapidly growing student populations have these costs much more often than districts with stable or declining student populations.

Facility Grant	=	Up to 8% of Construction Costs
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The 2005 Legislature increased the limit for the total of district facility grants beginning in 2007-08. The grant total in

2005-07 cannot exceed \$17.5 million and is prorated down if eligible costs exceed \$17.5 million. Beginning in 2007-09 the grant total cannot exceed \$25 million and is prorated down if eligible costs exceed \$25 million in a biennium. This may increase the current effective rate of 3%-4% of construction costs by a percent or two. The facility grant remains initially at 8% of the total construction costs of new school buildings excluding land. New buildings include additions and portable classrooms, but exclude buildings not used for some classes such as a central administration building.

The 1997 Legislature established the facility grant, but delayed implementation until 1999-00. The grant is for costs to equip and furnish a facility and cannot be used for construction costs. This was partly in response to 1996 Measure 47 (included in Measure 50) that limited construction costs that could be bonded to those that are intrinsic to the structure.

Transportation Grant

The transportation grant did not change in 2005. The revised equalization formula section below includes a brief description.

General Purpose Grant

The 2005 Legislature did not change the general purpose grant. The revised equalization formula section below includes a brief description.

Revised Equalization Formula Summary

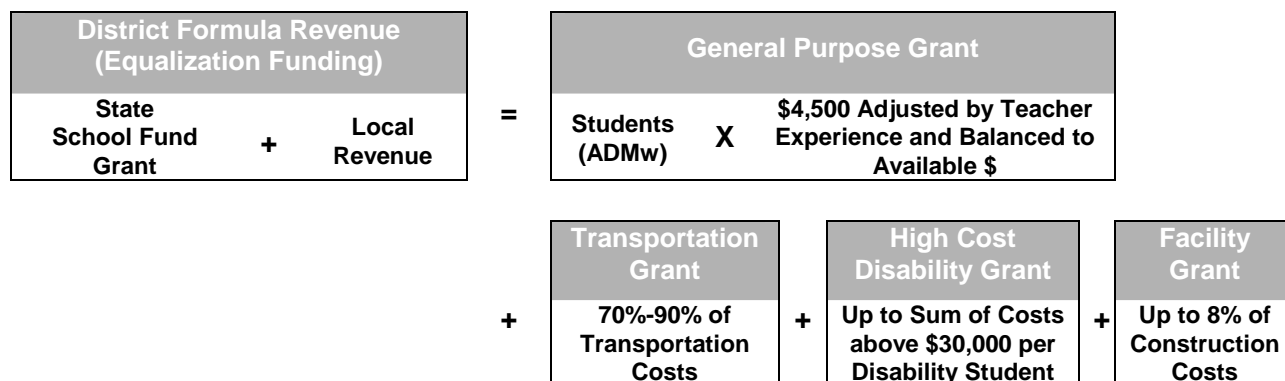
School District Equalization

The K-12 school equalization formula allocates most state and local operating revenue available to local school districts. Local revenue stays with the district where collected, but is treated like a state resource. The combination of state and local revenue equals a measured financial need. The formula does make a facility grant, but does not allocate any other capital resources. The formula also does not allocate state and federal categorical aid. These funds are dedicated to specific programs and cannot be used for general purposes.

The K-12 school distribution formula allocates funds based largely on a per student basis. For purposes of the formula, "student" means weighted average daily membership (ADMw) extended. Weighting means counting a higher cost student as more than one. Extended means the higher of the current year or prior year ADMw.

The formula includes four grant calculations for each district. These are a general purpose grant, a transportation grant, a high cost disability grant and a facility grant. For a more complete description of the formula pre-2005 changes, see Research Report 3-04

K-12 SCHOOL EQUALIZATION FORMULA



State aid is State School Fund money available for distribution to school districts. Local revenue includes property taxes, County School Fund, Common School Fund and a few other sources. No changes were made to local revenue sources included in the formula.

The general purpose grant starts at a \$4,500 target per weighted student. Applying the teacher experience factor increases or decreases the \$4,500 per student target by \$25 for each year the district average experience is more or less than the statewide average teacher experience. A calculated percentage adjustment factor (currently about 116%) modifies the adjusted target amount to allocate the full state and local funds available. The grant accounts for about 95% of formula revenue. Thus number of students and their associated weights are a very important determinate of district formula revenue. There are no constraints on how this money can be spent.

The transportation grant is a 70% to 90% reimbursement of approved student transportation costs. These costs are primarily school bus costs for transport between home and school and class field trips. Districts are ranked by costs per student. Districts ranked in the top 10% have 90% grants. Districts ranked in the next lower 10% have 80% grants and the bottom 80% of districts have 70% grants.

The high cost disability grant is initially the sum of the costs above \$30,000 for each student with disabilities. ESD costs for each student can be included in the total. The total grants for all districts cannot exceed \$12 million per year. If eligible costs exceed \$12 million, grants are prorated down to sum up to \$12 million.

The facility grant is up to 8% of the construction costs for new classrooms, but is subject to a biennial limit of \$17.5 million in 2005-07 and \$25 million beginning in 2007-09. The grant is for classroom equipment that cannot be included in bonded debt. If eligible facility grants exceed the biennial limit, grants are prorated down to be less than 8% of construction costs.

ESD Equalization

The 2005 Legislature changed the ESD share of state and local funding, but did not modify the final 2005-06 phase-in of equalization for ESDs as specified in 2001 legislation. The ESD share is 5% of total state and local formula revenue in 2005-06. The Legislature reduced the 5% to 4.75% beginning in 2006-07. This is a 5% reduction in ESD funding and reverts the ESD share back to what it was in 2003-04.

Allocation Formula

$$\boxed{\text{Base Revenue}} = \boxed{5.263\%} \times \boxed{\text{Sum of Component School District Revenue}}$$

In 2005-06 the base revenue is 5.263% times the sum of the school formula revenue for the ESD component districts. With the ESD total state and local share set at 5%, the ESD percent applied to the

school district 95% must be more than 5% (5.263% X 95%=5%). Beginning in 2006-07 the base revenue share is 4.99% (4.99% X 95.25% = 4.75%).

The district minimum allocation is \$1 million. If the base revenue allocation is initially less than \$1 million, the base is increased to the \$1 million minimum. The statewide base total is then more than funds available, so the base is proportionately reduced by a percent slightly less than 100%. This makes allocated funds equal to available funding.

$$\boxed{\text{State and Local Revenue}} = \boxed{\text{Percent to Balance}} \times \boxed{\text{Higher of (1) Base Revenue (2) \$1 million}}$$

If an ESD's local revenue is greater than its general services revenue, then the State School Fund grant is zero. Any local revenue in excess of the allocation is distributed to component districts proportional to ADMw (extended) and is included as local revenue for them in the school formula the following year.

ESDs in their role of assisting component school districts are assumed to have the same relative need for funds as their component school districts. Thus the financial need of ESDs is proportional to the needs of their component school districts (except for the \$1 million minimum) and should depend on the same factors used for school district equalization. The K-12 school equalization formula is essentially the adopted definition of equity for both school districts and ESDs.

RELATED REPORTS

The following reports deal with recent school finance legislation in more detail. The summaries are a condensed overview of the K-12 equalization formula and ESD allocation. Reports are also available for the 1997, 1999 and 2001 legislative sessions.

"K-12 and ESD School Finance: State School Fund Distribution," Research Report #3-04

"K-12 School Equalization Formula: State School Fund," two page summary

"ESD Equalization: State School Fund," one page summary

"School Local Option Property Tax: Legislation and Utilization," Research Report #4-04

"The Education Stability Fund," Research Report #5-04

"2003 School Finance Legislation: Funding and Distribution," Research Report #7-03