

School Finance 201

The initial briefing the Commission received on the structure of Foundation School Program was essentially School Finance 101: What is the structure of the program? It covered in detail many of the functional aspects of how the formulas and weights impact the funding of schools and students. School Finance 201 provides answers to the question of “Why?” – explaining how those formulas and weights were created, the reasons they were established and why they are still important.

The State Policy in Sec. 42.001 is that “each student enrolled in the public school system shall have access to **programs and services that are appropriate to the student's educational needs** and that are substantially equal to those available to any similar student, **notwithstanding varying local economic factors.**” It further includes in the mandate for equity, “**after acknowledging all legitimate student and district cost differences.**” The Purpose of the Foundation School Program in Sec. 42.002 guarantees “a basic instructional program and facilities **suitable to the student's educational needs**”. (*emphases added*)

The formulas and weights were established in 1984 to implement that policy and purpose. To accomplish this, the core underlying principle is that, while the basic costs of the program are shared between state revenues and local property tax revenues, extra costs that are **beyond the control** of the local district are borne by the state. Otherwise, taxpayers in districts with disproportionately higher uncontrollable costs would face a similarly uncontrollable higher tax rate burden.

Costs that are within a district’s control are primarily the district’s responsibility. For controllable costs, the state only provides what is necessary to achieve “substantially equal access to similar revenue per student at similar tax effort” (from the State Policy and the *Edgewood I* decision) and “access to a substantially equalized program of financing in excess of basic costs” (from the Purpose). This is one of the two major purposes of Tier 2. It attempts to guarantee a similar tax rate in each district for providing a given level of program enrichment. The other purpose will be addressed later.

Of course, providing appropriate funding does not guarantee that it will be used wisely, but lack of such adequacy all but guarantees an inability to provide an appropriate education for the entire range of students, other than in exceptional circumstances. Districts are faced with providing insufficient programs for everyone or focusing appropriate resources on some at the expense of others. In other words, appropriate funding is necessary, but not sufficient by itself.

How the formulas and weights were derived

After the 68th Legislature established the Perot Commission in 1983, an *ad hoc* working group consisting of representatives from virtually every education organization went through a year-long modeling process to determine the cost of a basic education and the reasons and degree to which costs were uncontrollably higher for various types of districts and students. The basic cost, or basic allotment, was intended to represent the minimum cost of providing an accredited education to a student with no special needs in an efficiently-sized district with the lowest competitive costs for salaries.

To determine that basic cost, the working group “built” and determined the costs of models of optimally sized and staffed elementary, middle and high schools using a consensus approach. Additional costs were estimated for district-level expenses and the total cost for an efficiently-sized district was then divided by the number of students to establish the basic allotment.

The same procedure was used to model schools at less than optimal sizes and to model the incrementally higher costs of appropriate instructional arrangements for students with various special needs, as well as to model central costs for different types of districts. These higher costs were then used to create recommendations for the small district adjustment and many of the program weights. Also recommended was creation of a “price differential index” to adjust for market wage variation and possibly other identifiable uncontrollable district-level cost differences. Finally, they recommended regular “accountable cost” studies to update the basic allotment, formulas and weights.

From Recommendations to Legislation

Those recommendations served as the basis for the current formula structure, but they did not result in the actual levels of the basic allotment and weights. To reduce the cost of adopting the new system, the adopted basic allotment was reduced to less than 75% of the recommended amount. In subsequent years it never exceeded that percentage compared to accountable cost study recommendations.

The working group study examined a number of models for delivery of effective compensatory and bilingual education services. Smaller class sizes, the use of education aides to assist the teacher, extended day and extended year programs, and the cost of additional instructional materials and obtaining/retaining qualified teachers were all reviewed. Costs of the arrangements ranged from slightly over 40% to as much as double, compared to the cost of a regular education program for each grade grouping (elementary, middle, and high school.) For example, the per student cost of a teacher's salary is 46.7% higher for a class of 15 students, which was frequently cited in studies at that time as the maximum level where substantial improvement could be achieved, than at the maximum class size in elementary school of 22 students adopted in HB72. An educational aide with sufficient ability and experience to make a difference would likewise have a salary of 60% or more of a teacher's salary and would be an additional expense for each class if that arrangement were used.

To stay on the conservative side, the group rounded the least expensive model down to the same weight of 0.4 (40% more) for compensatory education that had been recommended in the 1974 Governor's study conducted by Dr. Richard Hooker. It was felt that these same basic instructional arrangements would work for students who were ELL but non-disadvantaged. A combination of significantly smaller class sizes and extended day/year programs would be necessary to intervene successfully with students who were both. Therefore, the group recommended the same 0.4 weight for bilingual education and further recommended that they be cumulative for students meeting both conditions.

I personally drafted the initial versions of the finance sections of HB72 and its Senate counterpart, SB4, at the request of the leadership of the respective houses. To contain the cost of the legislation, I was instructed to reduce the weights in the Senate bill, prior to its introduction, to 0.3 for compensatory and 0.2 for bilingual education. Similarly, on the House side, the weights were reduced to 0.2 and 0.1, respectively, in the filed bill. In conference committee, the House position prevailed. Several subsequent studies using different methodologies have substantiated the original 0.4 weights.

Special education weights adopted at that time were based primarily on the impact of significantly smaller class sizes for the various instructional arrangements. They were changed in later years by arbitrarily reducing the weights for separate instructional arrangements and providing significantly larger support for full and partial mainstreaming in an attempt to increase mainstreaming through economic pressure. Although it was recommended that studies should establish varying weights for different career and technology instructional arrangements, this was never done and a single weight was applied regardless of a program's actual cost. No studies were conducted for the gifted and talented weight, the

new instructional facilities allotment and the high school allotment – values for each were arbitrarily set in law.

Formulas and Weights – What’s the Difference and How Should They Interact?

Formulas adjust for differences between districts in the uncontrollable costs they face in purchasing goods and services, the diseconomies of scale that impact those costs and in the differing ability to pay for those costs locally. Weights adjust for cost differences for various students based on the uncontrollable differences in the costs of various necessary instructional arrangements.

Because most instructional arrangement differences are based either on class size or on additional hours or days of instruction, they are directly proportional to regular program costs, as in the example of 22 students versus 15 students described earlier. Similarly, they are directly proportionally impacted by uncontrollable salary differences without that changing the proportional cost of the instructional arrangement, as this table illustrates:

	District A	District B
Salary	54,000	60,000
per 22 students	2,455	2,727
per 15 students	3,600	4,000
cost ratio	147%	147%

Separating the salary cost from the instructional arrangement cost would make both inaccurate. Making the instructional arrangement adjustment a fixed dollar amount rather than a percentage weight would similarly fail to properly describe the real cost difference.

By the same token, while raising the basic allotment does provide more money for special needs students, it does not make up for failure to properly fund the proportionate cost differences. If the cost for a regular program student is \$5,000 and it really costs \$7,000 (40% more) to provide an appropriate education for an English language learner (ELL), raising the basic allotment to \$5,500 doesn’t close that gap. If the extra \$550 it would generate for ELL students (\$500 + 10% of \$500) merely plugs holes in their program while regular students have an additional \$500 for their programs or teachers’ salaries, it would now take \$7,700 to properly fund ELL and the dollar amount of the shortfall has actually grown from \$1,500 to \$1,650 (\$7,700 - \$6,050).

The Free Market and School Districts

Like every consumer, school districts compete in and are affected by the free market. This is particularly true with respect to wages, which make up the vast bulk of school district expenditures. In recognition of the degree to which markets vary widely across a state as big as Texas, the legislature created what is now called the Cost of Education Index (CEI) “to reflect the variation in known resource costs and costs of education beyond the control of school districts”. This has become exclusively an adjustment for salary market factors.

The CEI currently in use was adopted in 1990 and was based on market factors in place in 1989. Numerous attempts to update it have failed, primarily because the studies were instructed to produce a new index that didn’t change the overall cost of the Foundation School Program. This made it a zero-sum game, and costs that had become higher in some districts could be recognized only by reducing funding in other districts, even if their costs had not gone down. Since the legislative process is designed to make it easier to kill than to pass legislation, that snapshot in time still governs today.

It would be a serious mistake, however, to presume that it would be better to eliminate the CEI if it can’t be replaced or at least updated. The current CEI primarily adjusts for three market factors. The largest

is the competing salaries paid by neighboring school districts, which can raise a district's basic allotment by up to 6.4%. Next is the size of the district, which raises the basic allotment by 5% for districts with 8,500 or more ADA and lesser percentages for smaller sizes. Third is the percentage of economically disadvantaged students for districts with at least 50% of their students eligible for free or reduced lunch, which can increase the basic allotment by up to 3.55%, to attract quality staff to high-poverty schools.

While other competitive salaries may matter in some markets, all districts are directly impacted by what their neighbors pay if they want to retain their teachers and other staff, and districts that were in high-cost markets in 1989 are still in high-cost markets today. Similarly, districts that were large in 1989 still are, and districts that had high percentages of disadvantaged students still do. In each case, there are other districts that are now more heavily impacted by those factors: neighboring salaries have increased as urban and suburban communities have expanded into rural areas, small rural or suburban areas have become large suburban communities and the urban poor have spread into the suburbs. Still, the bulk of students are in districts for which those three market circumstances have remained high, and it would be hard to argue that those factors no longer matter.

Small/Mid-size/Sparse

The other main factor that causes “variation in known resource costs and costs of education beyond the control of school districts” is the result of diseconomies of scale. If a basic allotment is based on “optimal” (the balance between efficient and effective) class sizes in the various grades, i.e. the 22 students to which kindergarten through grades three are limited, the cost per student is uncontrollably higher in a small districts where there may be only 16 or 17 students in each grade. The modeling process has indicated a gradually increasing percentage of cost as student numbers decrease, with the percentage rising sharply as school size gets extremely small.

The overall effect is a hyperbolic curve and the FSP approximates that by using two separate formulas, the small and mid-size adjustments, with an additional tweak (the sparsity adjustment) to reflect the extremely high per-student costs in extremely small districts. The small district formula can increase the adjusted basic allotment (after the CEI is applied) by 60% for a district with only 100 students and the sparsity adjustment can triple or quadruple that amount for districts with fewer than 70 students. One district with only 6 students last year had 87 weighted ADA almost entirely as a result of the sparsity adjustment.

Why Tier 2?

Tier 2 was created to serve two purposes. The more recognized one, as described in the Purpose in Sec. 42.002(b) is to provide “substantially equal access to funds to provide an enriched program”. This is particularly important in light of the Supreme Court’s requirement in the *West Orange Cove* decision that districts have “meaningful discretion”.

Because the determination of the basic allotment and weights was based on “optimal size” and averages and most schools are neither optimally sized nor faced with average costs, there are margins of error in each. That’s not a problem for districts or programs with uncontrollable costs below average compared to similar districts or programs – they get to reap the benefits of this small “overfunding”. For districts and programs with above-average necessary costs, Tier 2 provides an equalized ability to properly fund essential basic programs.

It is not necessary to have multiple tiers. Both of these purposes can be addressed through a properly structured single tier system, either through a single yield applied to all pennies or through a percentage adjustment applied to the basic program based on the ratio of an adopted tax rate to the local share tax rate.

A Few Points About Facilities

State aid for facilities and debt service averaged between \$700-\$800 million per year during the first part of the millennium. It has dropped from \$740 million in 2007 to less than \$430 million – a decrease of over 40% – while the student population has grown by 20%. When the Existing Debt Service Allotment was created, over 90% of districts were eligible and the state paid over 30% of total facilities and debt service cost. The preliminary Statewide Summary of Finances estimates the state share for this year will be 6%. Fewer than half of all districts are eligible and only about a third receive state facilities aid.

This decline is primarily the result of a yield (and therefore wealth level) that was frozen at the 1999 level while property values and district wealth (and the cost of construction) have dramatically increased. The fact that only some pennies of debt service are equalized, leaving the rest to be totally reliant on local wealth and yield, has exacerbated the problem.

Another key cause is the failure to recognize uncontrollable cost differences. Tiers 1 and 2 make adjustments, although imperfect, for such costs, but facilities funding is based on average daily attendance with no adjustments. Fast-growth districts, districts with high property and construction costs, and districts with aging or inadequate facilities in need of repair or replacement are treated the same as districts with no special cost needs.

As a result, local I&S collections have more than doubled since 2007, from just over \$2.7 billion to nearly \$6.5 billion for the current school year. This has been one of the major contributors to the overall increase in local property taxes.

Why Equity Is Necessary for Adequacy

Beginning with the *Edgewood I* decision, the Supreme Court has recognized the necessity of equity in meeting the constitutional mandate for public education. This is echoed in the “substantially equal access to similar revenue per student at similar tax effort” language of the State Policy and the “substantially equalized program of financing” language in the Purpose.

There are several major reasons why it is impossible to adequately fund education for all students if there is significant inequity in the system. The obvious one is waste. Money allocated for reasons other than necessary costs drives up the cost of the whole system. Given limited state resources, that reduces the likelihood that sufficient revenue will be allocated to the remaining school districts.

In addition, there is the impact of competition. If inequity allows one district to pay higher salaries or provide other, better working conditions at lower tax rates, the neighboring districts then must raise their salary and other costs to hold onto their good personnel. This makes adequacy a moving target that they are unlikely to reach.

Finally, there is politics. Legislators representing districts that are adequately funded due to inequity are less likely to vote for sufficient funding for the overall system, leaving the remaining districts short of appropriate funding.

But not all money distributed inequitably is wasted. Given the overall inadequacies and outdated nature of the current formulas and weights, it is possible or even likely that revenue received by districts for non-cost-based reasons is needed by those districts. The problem is that districts without that special treatment have those same needs, and those aren't being met.

Far more Texas students are educated in districts that do not receive preferential treatment. If the goal is truly to educate all of our students, all districts must be funded through a system that properly reflects their needs. There isn't any extra money to waste on arbitrary extras.

Does Money Matter?

Separate written testimony with that title addresses the question. It summarizes studies I conducted at two separate times, where the impact of funding differences on student performance and district accountability ratings are analyzed using Texas-specific data.

The conclusions of both studies are overwhelming – money does matter.

Summary Conclusions and Recommendations:

- 1. Money matters. Funding that is adequate to provide the appropriate programming for the wide variety of student needs in the wide variety of Texas schools makes a difference when it is well spent. Lack of appropriate funding almost always makes a difference – a negative one.**
- 2. Equity matters. Adequacy for all is not possible without equity. At least some, and likely many students will not be adequately funded if the system is inequitable.**
- 3. The current school finance system was built on an equitable base, but some features were inadequately or inequitably funded from the beginning and others have been allowed to become outdated. All weights and formulas should be continuously reviewed and based on currently updated data.**
- 4. The system will not be significantly changed in a zero-sum game.**
- 5. Significant change has only occurred when it was understood why the money was needed and what it would buy. Absent a “hands-on” modeling process, money is an abstract and numbers become a “he said / she said” battle between groups with no real validation.**
- 6. The biggest shortfalls in adequacy are in funding programs for economically disadvantaged students and English language learners. Appropriate weights will likely be determined only through a process of modeling and costing out instructional arrangements that are both effective in closing the performance gaps and are scalable and widely and easily replicable over a state as big and diverse as Texas. One size will not fit all.**
- 7. School property taxes have risen dramatically in large measure because the only factor that is constantly updated is district property wealth. As that rises, state support decreases unless the formula values – particularly the basic allotment – are also updated.**
- 8. The biggest impact on reducing local property taxes would be achieved by restoring facilities funding to levels that would cover the original numbers of districts and students and compressing tax rates to reflect the higher yields. Further reductions in districts with the highest tax rates could be achieved by equalizing all pennies and by adopting weights that reflect the uncontrollable factors that influence the cost of and need for new facilities.**
- 9. Raising the other “frozen” yield – for the Tier 2 “copper pennies” – and compressing rates accordingly could provide further property tax relief.**
- 10. Severely outdated formulas such as the CEI and transportation could at least be updated using current data. For the CEI, districts could be distributed along the lines that are generated by the three main factors based on the average of their data for the three most recent years. For transportation, the allocations per route mile for each of the linear density categories could be proportionately increased to reflect the rise in costs since they were adopted in 1984.**