

M I N U T E S

SPECIAL COMMITTEE ON SCHOOL FINANCE

June 20-21, 1977

The Chairman, Senator Harder, presided. All members except Senators Warren and Angell were present.

Staff Present Included: Richard Ryan, Julie Mundy and Ben Barrett from the Kansas Legislative Research Department; Avis Badke from the Revisor of Statutes' Office; and Dale Dennis from the State Department of Education.

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Conferees Present Included: Dr. Darwin Daicoff, Professor of Economics, University of Kansas and Dr. John J. Callahan, Director, Legislator's Education Action Project, National Conference of State Legislatures.

Minutes

The minutes of the May 17 meeting were approved unanimously.

Analysis of School District Equalization Act
(SDEA) - Dr. Daicoff

Dr. Daicoff made the following comments and observations relative to his study entitled "An Analysis of the Kansas School District Equalization Act of 1973."¹

1. It was noted that "averaging" district wealth over a period of years has the effect of reducing the major fluctuations in district wealth that occur from year to year.
2. An analysis of the effects of the income tax rebate distribution suggests it tends to reduce equalization by favoring small, wealthy districts and working to the disadvantage of poor, large districts.
3. A general inverse relationship between district wealth and state aid was observed.
4. An analysis was made of the relationships of certain school finance items and school district characteristics such as those districts with Black or Spanish-surnamed pupils, and those with urban and rural identifications. Measures of districts with high or low numbers of poor, median income, or rich families also were included. It was concluded that after the SDEA was enacted, district wealth disparities increased. (This was to be expected because the SDEA did not attempt to equalize wealth.) Districts with Black and Spanish-surnamed persons gained in terms of state aid as a result of the SDEA. After the SDEA, rural district expenditures increased, but not as rapidly as urban district expenditures. State aid in urban districts more than doubled, while state aid to rural districts increased only a little. Concerning the income measures, expenditures increase in both those districts identified as having large numbers of rich or poor,² but state aid increased most in the districts which were rich in terms of measures of income.
5. Based upon a statistical tool known as a Gini Index, it was found that after the SDEA, district wealth, state aid and local revenues were distributed more unequally than before, but per pupil expenditures were equalized somewhat. (This finding is to be expected under a program designed to equalize the ability of districts to make comparable efforts to spend at similar levels. To accomplish this requires some districts to receive substantially more state aid than others and some to produce more local property taxes than others.)

¹ A copy of this study was sent to each Committee member.

² "Rich" or "poor", as reported in 1970 census data.

6. The negative relationship between tax rates and wealth or budget was greatly reduced by the SDEA. The negative relationship between wealth and tax rates remains only in small school districts.

7. After SDEA, tax rates were relatively higher for the rural/farm, poor and low income districts. Large tax rate increases occurred in districts with no Black or Spanish-surnamed persons, rural/farm, low income, and lower portion of both rich and poor. Tax rates actually declined in districts with Blacks and in rural/farm, high income and portion rich districts.

In response to a question, Dr. Daicoff, from his personal analysis of the SDEA stated that the amendments to the SDEA since its enactment have not contributed much to the concept of equalization. Specific observations included:

1. The income tax rebate should be made a part of the power equalization formula.
2. From the standpoint of equality, the "grandfather clause" is without justification.
3. The job of equalization should be completed by including within the general fund the levies of various special funds (i.e. social security, special education, etc.) which are now outside of the power equalization formula.

School Finance Programs Among the States -
Dr. Callahan

School Finance Trends. Dr. Callahan identified several trends in school finance plans since the original Serrano decision. These included the following:

1. Major new demands have been made on state budgets. Thus, reform has resulted in a higher level of state involvement in school finance. In some states, this has resulted in major changes in tax bases and increases in the state's percentage of support for education.

2. Property tax relief or control has been emphasized. Controls such as property tax lids, uniform levy requirements, and budget or expenditure controls have been used. At the same time, some new programs of property tax relief, such as homestead exemptions, also have been initiated.

3. Spending equalization has begun to occur. That is, in some states the difference among school districts in spending levels has diminished.

4. Greater attention has been focused on educational need. A half dozen or more states employ some type of weighting system for state aid distribution purposes. More revenue is being placed behind children with special needs.

5. The increased activity and concern at the state level has resulted in much greater state-federal conflict on educational issues. Dr. Callahan regards this as constructive tension. As both the Congress and state legislatures become more assertive, this tension can be expected to increase.

6. New problems are receiving increased attention in conjunction with or as a result of school finance reform. These include such matters as declining enrollments, solvency of teacher retirement systems, teacher competency, class size, parental involvement in the schools, and educational accountability and productivity.

Afternoon Session

School Finance Programs Among the States (continued)

Litigation. Dr. Callahan stated that since the U.S. Supreme Court decision in Rodriguez, most litigation has been based on the equal protection and education clauses of state constitutions. The greater focus has been upon the education clauses in those states that have strong education provisions. At least three states currently are under a court order to revise their finance systems - Connecticut, New Jersey and California.

In California, the Court has given direction to the effect that at any specific level of taxation there may be an expenditure variation of no more than \$100 per pupil. A minimum grant concept has been ruled unconstitutional. The financing of local schools must be a function of state wealth, not local wealth.

New Jersey has a "thorough and efficient" provision in the education clause of its constitution. Dr. Callahan said the state supreme court has required that the educational mandate is that each child must receive the training and education necessary to compete in the labor market and to be a productive citizen.

The Connecticut constitution requires a general and uniform educational system. Its flat grant state aid program was stricken down because the Court found that the system provided no equalization and because there was wide variation in educational spending.

Dr. Callahan commented on a case pending in the State of Washington. In that case, a lower court held that it was the paramount duty of the state to provide an ample educational program. This is a state duty which cannot be delegated to local units.

Dr. Callahan mentioned that there are also a great number of special interest cases pending which may have an impact on school finance. Many of these cases involve handicapped persons.

It is Dr. Callahan's opinion that the courts look with suspicion upon state finance laws which allow wide variation in the financial aspects of school aid programs. The courts are concerned with what the language in the state's education clause means and on how much responsibility for education can be delegated to the local level. The courts are taking a critical view of unequitable features, such as grandfather clauses and flat grant finance programs.

District Wealth. In a discussion about methods of measuring the wealth of school districts, the following points were emphasized:

1. Most states use some type of equalized property value as a measure of school district wealth.
2. Interest has developed among the state for some additional measures of wealth, such as income, the idea being that wealth consists of more than a property dimension.
3. Legislatures around the country are seeking to obtain school district data on both income and property. It was noted that as measurements of wealth are changed, reallocation of state resources is likely to be very significant.
4. Many states are experiencing problems with the property assessment process. This is due to several factors, including poorly trained assessors, differences in assessment practices, political pressure on assessors, and difficulty in dealing with unusual factors affecting property values in given areas.
5. The rapid inflation of property values has caused many problems for school finance, as such increased values may be outstripping the ability to pay the increased taxes.
6. The use of income for school finance purposes may bring some stability to school revenue resources. In this connection, more states are studying the income productivity of property and other differential assessment practices which might be applied to property.

Budget Controls. Dr. Callahan indicated that budget controls are becoming increasingly popular. Budget controls help force property tax relief when large amounts of state aid are infused into a school finance program. These controls may make it possible to restrain high spending districts while accelerating the spending of poorer or low expenditure districts.

Concerns expressed about budget controls emphasize that such controls may be too restrictive. They may freeze spending at levels too low to allow school districts to provide a full range of quality programs. Where laws contain "safety values" to allow school districts by local option to exceed their expenditure controls, these work to the advantage of the richer districts who are much more successful at passing referendums of this type than poorer districts.

Cost Adjustments. Some states do have adjustment devices in school finance formulas which are designed to accommodate factors causing differences in educational costs among school districts. Diseconomies of scale have been documented in both very small and very large school districts. In some southern states, bonuses are provided to school districts to encourage them to employ better educated teachers. In Florida, a price level index is used in adjusting the state aid of school districts.

Among the factors which contribute to the existence of spending variations are size of the district (small or large), area labor market characteristics, degree of unionization, wealth, school practices in hiring and making class size determinations, composition of the teaching force, and pupil characteristics.

Dr. Callahan stated that if cost indexes are to be used, they must be composed of factors over which the school district has no direct control. Otherwise, manipulation will occur.

Indexes can be prepared to identify cost variations, but they are imperfect because there presently are many factors that cannot be fully taken into account. Also, it was noted that cost indexes can be counter-productive. For example, if a district receives less state aid than another district because of a low cost of living index, this may encourage such a district to hire "cheaper" or lower-quality teachers and have poorer programs because it does not have the funds to compete aggressively for better teachers or to enrich its programs.

If there are more simple ways of recognizing the differences in costs among the various school districts, these should be considered as alternatives to an elaborate cost index system. Classification of schools by size may be one possibility. A direct targeting of high cost educational programs may be another useful approach.

It was noted that New York provides additional funds to schools which have a high proportion of students who receive low scores on standardized tests. California has a program that rewards school districts for improved proficiency.

Property Assessment Among States. Dr. Callahan, described the trends he has observed among the states in regard to property assessment practices. Most states have some type of "full value" or "uniform" assessment requirement in their constitutions.

1. There has been a movement among the states toward differential assessments. In many cases, this has focused on preferential treatment of farm land. A few states have a complete system of differential levels for different classes of property.

2. Greater use is being made of ratio studies to determine the actual value of property.

3. More state control is being asserted over assessment activities. In Montana and Maryland, all assessing is done at the state level. Some states are increasing their involvement in assessor training activities.

4. Some states assess certain types of property at the state level, such as public utilities; industrial property, mineral or forest lands, and remote areas.

Dr. Callahan's personal opinion is that the state should become more actively involved in assessment activities. Local assessors do not possess the skills or, in some cases, the desire to assess property at its full value. Large scale property may be difficult to assess, and the wealth associated with certain types of property may not directly be related to the place in which the principal plant is located. Property values of similar property may fluctuate greatly in certain "pockets" because of the influence of a number of factors. Properly taking these differences into account may require great expertise.

Recommendations Concerning the SDEA. In reply to a question, Dr. Callahan made the following comments concerning changes that should be considered in the SDEA.

1. The grandfather clause should be eliminated.
2. The income tax rebate should be included within the purview of the power equalization formula.
3. The budget controls should be reviewed to determine whether or not they are fiscally prudent. They should not be unduly restrictive for low spending districts. More flexibility should be provided if the present controls restrict material improvement in educational programs.

Dr. Callahan agreed with Dr. Daicoff's suggestion that equalization would be enhanced by power-equalizing the levies for the various special funds of school districts.

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General Discussion

Dr. Callahan observed that, in his judgement, the Kansas SDEA is a relatively sound law. Insofar as the interim study is concerned, efforts should be directed toward improvements in equalization aspects of the law. Also, the components dealing with district wealth and budget controls are significant parts of the study.

Concerning P.L. 874, Dr. Callahan stated he believed the states had made considerable progress in terms of bringing to the attention of Congress the problems associated with this program. However, there is no assurance Kansas will be successful in its efforts to continue to consider P.L. 874 receipts as a part of a district's local effort.

Staff Presentations

Mr. Ryan outlined the research projects which will be covered in the July 14 and August 16 and 17 meetings. The July meeting will cover Project 3 - Budget Controls (except for budget appeals) and Project 6 - Transportation. The August 16 and 17 meeting will focus on Project 1 - District Wealth and Income Tax Rebate and a portion of Project 5 - P.L. 874 Funds.

Staff reviewed the procedures which would be followed if any or all of the levies for the special funds - social security, special education, vocational education, workmen's compensation, and unemployment compensation - were power-equalized. Also discussed were some of the reasons the 1973 Legislature opted not to power-equalize the levies for the social security, special education, and vocational education funds when the SDEA was enacted.

Staff reviewed the following items which are included in the Committee files:

1. "Unified School District Tax Rates for Four Special Funds, 1976," June 20, 1977, Kansas Legislative Research Department and Division of Financial Services of the Department of Education.
2. Memorandum and eight computer applications: "Power Equalizing Four Special Tax Levies," June 20, 1977, Kansas Legislative Research Department and Financial Services Division of the Department of Education. (The computer applications show the estimated effects in 1976-77 of power-equalizing the school district levies for special education, vocational education, social security, and workmen's compensation. Separate runs were made for the first three levies and one run combined all four levies. Four applications assume a local effort rate (LER) of 1.77 percent. The other four have adjusted LER's to keep state aid at the actual 1976-77 level.)
3. Memorandum and two computer applications: "Background of County School Foundation Fund and Effects of Elimination of Such Fund," June 20, 1977, Kansas Legislative Research Department and Financial Services Division of the Department of Education. (The computer applications show the estimated effect in 1976-77 under the SDEA of eliminating the county school foundation fund levy. One computer application assumes a 1.77 percent LER. The other application adjusts the LER to keep state aid at the 1976-77 level.)
4. "'Grandfather Clause Aid' Under the School District Equalization Act (SDEA) - 1976-77", June 20, 1977, Kansas Legislative Research Department and Division of Financial Services of the Department of Education.

Representative Duncan reported concerning the Florida Price Level Index which is used in that state to adjust the state aid entitlements of school districts. Material concerning that program was provided to the staff and is on file in the Kansas Legislative Research Department.

Afternoon Session

Industrial Revenue Bonds (IRB's)

A part of the research project dealing with district wealth includes a consideration of whether the definition of district wealth should be expanded to include an amount equal to the value of tax-exempt property financed by IRB's.

Staff reported that if this matter were to be seriously considered, there are certain significant problems and policy questions which must be resolved. Presently there is no reliable state level information available as to (a) in the school districts in which IRB facilities are located, (b) the assessed valuation of such properties, and (c) the precise tax-exempt status of many of the projects. Such information would have to be secured by surveying the county appraisers. This would require a considerable amount of time and effort on the part of these local officials, especially the responsibility for assigning an accurate valuation to a facility.

A rough estimate, based on the amount of IRB issues to date, as tabulated by the League of Kansas Municipalities, was prepared to show the possible impact under the SDEA of including such property in district wealth. The table "Rough Estimate of the Effect of Including In District Wealth Property Financed by Issuance of Industrial Revenue Bonds" is filed in the Committee notebooks. Based on the assumptions in the table, the statewide 1976-77 effect of such a policy suggested that state aid requirements under the SDEA would have been reduced by about \$2.5 million (a little more than 1.0 percent of total general state aid).

The Committee decided to delay making a decision about whether to survey the county appraisers to obtain the data needed to obtain a more accurate estimate of the effect of including IRB property in district wealth. However, for the July meeting the staff was instructed to check on answers to the following questions:

1. Who holds the title to IRB-financed properties during the duration of the bond issue?
2. When a second or subsequent IRB issue occurs for the same facility, what happens to the title?
3. What does the law provide with regard to payments in lieu of taxes on behalf of a facility financed by IRB's?
4. What are the legal requirements for placing the original improvements or equipment financed by IRB's back on the tax rolls? How is this affected by subsequent issues for the same facility?

Other Matters

The convening time of the July 14 meeting was set for 9:00 a.m. in Room 510-S of the State House.

Staff was directed to send to the members copies of "Urban Information Report" No. 121, re IRB issues, by the League of Kansas Municipalities.

The meeting was adjourned.

Prepared by Ben Barrett

Approved by Committee on:

July 14, 1977
(Date)