School Funding Advisory Council

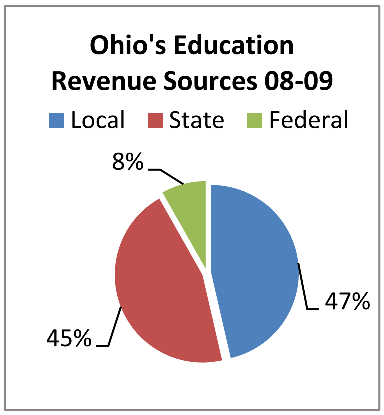
Ted Strickland, Governor
Deborah S. Delisle, Chair

Education Finance Overview

Meeting Brief – January 7, 2010

I. Introduction

School finance is an integral part of education policy and of comprehensive education reform. As the ultimate resource constraint, funding is at the heart of the difficult questions we face in trying to provide universal access to a high-quality education. Over the years, debates on the role of school finance in improving education have moved from isolated questions of funding and equity to a more integrated discussion of educational goals and how to finance them.



In the United States, funding for schools comes from federal, state and local sources. The U.S. spent about $520 billion on education in 2006, the most recent year for which national data is available, with states contributing the largest share at $242 billion (46.5%). Local entities also provided $231 billion (44.4%), with federal sources comprising the remainder.[1] In comparison, for the 2008-09 school year in Ohio, 46.4% of education revenue came from local sources, 45.4% from state sources and 8.2% from Federal sources.

Ohio's education expenditures follow national trends, though the diversity of Ohio's school districts results in district-by-district variations in expenditure. School districts in Ohio range from sparsely populated rural areas to dense urban areas, suburban to small town, Appalachia to the Lake Erie coast, and industrial counties to farmland. This level of diversity, uncommon among states, presents unique challenges in the development of a state funding system that is both understandable and fair for every district.

This briefing will highlight the history and challenges of Ohio's funding system for traditional public school districts. The newly-enacted evidence-based model will be addressed more comprehensively in subsequent briefings. This document focuses on school funding in Ohio as it existed before the evidence-based model was adopted, as well as the overarching themes that continue to be relevant. While the policy objectives and specific elements of the system have changed over time, the basic structure of Ohio's school funding program has been in place for seventy years and is likely to remain for the foreseeable future.

II. How is state funding for education established?

Cost of education – Local contribution = State funding for education

Ohio supports its schools through a "foundation program." Foundation programs first determine the cost of education, and then distribute state funding for the cost of education among districts in a way that compensates for the different resources available to different districts. After the cost of education

[1] National Center for Education Statistics

for a district is identified, the local contribution, or "local share," is determined and "charged off" of the basic cost of education with the state providing the funding for the remainder of this cost. In Ohio, like most other states, the local share is generally raised through local property taxes[2] and the charge off is determined as a percentage of property values.[3]

Besides foundation programs, some states rely on "guaranteed yield" formulas that ensure a school district receives a certain level of funding for its tax effort, helping to equalize the differences in revenue raised by districts that have the same tax rates but different property values or revenue bases. Some states provide matching funds or incentives for districts to increase their own tax effort, while other states allocate resources based on the level of funding districts received in the prior year (usually temporary) and a few states grant funds to districts regardless of the local contribution. Note that these funding systems do not have to operate exclusively, and states often combine them to meet their unique educational and demographic needs.

III. How do we pay for education?

Cost of education – Local contribution = State funding for education

Ohio's state funding formula distributes resources based on the ability of each district to contribute local revenue towards the cost of education. Federal resources supplement these state and local resources. In FY 2007, Ohio ranked 18th in its overall expenditure per pupil spending according to the National Center for Education Statistics, spending about $17.7 billion on primary and secondary education, or $10,184 per student.[4]

State Funding Sources

Cost of education – Local contribution = State funding for education

State education funding is primarily supported by the state's general revenue funds, which are generated by a broad tax base through sources like income and sales taxes. Profits from the Ohio Lottery also go directly to support education, though in FY 2009 lottery profits made up only about 6% of ODE's budget. Primary and secondary education is the largest program area of state government (not including federal pass-through dollars), and comprises 42.6% of state expenditures.

Property Taxes

School districts rely most heavily on property taxes for support because property values tend to be stable, making them a dependable source of revenue. However, the variation in local property values across the state is significant, often exacerbated by the presence of business and commercial property.

[2] National Public Education Financial Survey, 2007. National Center for Education Statistics, U.S. Department of Education.
[3] Griffith, Michael. "State Education Funding Formulas And Grade Weighting." ECS Policy Brief – Finance/Funding Formulas. Education Commission of the States. Denver, CO: 2005.
[4] Ohio Department of Education

Equity issues arise because lower wealth school districts need higher tax rates in order to raise a given amount of revenue compared to wealthier districts. These issues are compounded by the fact that the poorest areas are usually the ones with the greatest need for educational services. A foundation formula helps to account for these inequities since "property rich" districts receive less in state funding for the cost of education than "property poor" districts.

Ohio has also helped to address wealth inequities through parity aid, a supplement first paid in 2002 to districts below the 80th percentile of property wealth. Parity aid provided extra resources for some districts above and beyond the cost of education determined by the state funding formula, which generally only wealthier districts could previously afford. The parity aid payment was based on the revenue generated by districts at or above the 80th percentile, but has been eliminated under the evidence-based model, which addresses equity through different mechanisms.

Charge-off (Local Contribution)

Cost of education − Local contribution = State funding for education

Under Ohio's first foundation program, in 1935, The expected local contribution, or "charge-off" was set at 3.5 mills, and it has steadily increased over time. Most recently, the charge-off was raised to 17.5 mills in 1968, to 20 mills in 1976, and starting in 1994 was gradually phased up from 20 to 23 mills. Increases in the charge-off allow the state to target more resources to lower wealth districts.

However, these changes also disconnected the charge-off from the local revenue raised through the property tax system, both because of the tax reduction factors (discussed below) and because districts are only required to levy 20 mills to participate in Ohio's foundation program. The disconnection between the local revenues raised and the calculation of a district's charge-off results in a phenomenon known as phantom revenue (also discussed below). Today the local charge-off stands at 22 mills, and language included in H.B. 1 (128th General Assembly) lowers it to 20 mills by 2014, which will eliminate the phantom revenue problem.

H.B. 920

In 1976, the state responded to the national trend of rising housing values and ballooning property tax liabilities with the enactment of property tax growth limits in H.B. 920. These limits, strict by national standards, prevent voted levies from raising more revenue on existing property than they generated in the year the levy was passed. When property values grow, the tax rates (current operating mills) are automatically adjusted downward through the tax reduction factors (TRFs). Though new property development and inside (unvoted) millage are exempted, the TRFs create a property tax system which raises roughly the same dollar amount as the previous year.

When these property tax limitations were amended into Ohio's constitution in 1980, provisions were included that allow for a minimum rate of taxation to keep the automatic TRFs from going too far. The level of that minimum rate, commonly referred to as the "floor," is set at 20 mills in the Ohio Revised Code. In practice, this means that the sum of all levies passed by a school district where property values are increasing will yield approximately the same nominal amount year after year until the TRFs bring the effective rate down to the 20 mill floor. After reaching the floor of 20 effective mills, the district may realize growth on those 20 mills when property values subsequently rise.

Phantom Revenue

As mentioned above, the interaction of the 23 mill local charge off with the TRFs created a problem for many districts known as phantom revenue. Phantom revenue is created when the state's funding formula assumes local revenue that the district does not have ("gap aid" phantom revenue) or assumes growth in local revenue that cannot be realized without the passage of a new levy ("reappraisal" phantom revenue).

"Reappraisal" phantom revenue can result when a district's property values increase through reappraisal or regular update by the County Auditor. Since the funding formula's charge-off is calculated as a percentage of property values, the district's expected local contribution towards the cost of education correspondingly increases. A district's true ability to meet what the state has determined for its local contribution, however, does not change from the previous year because the TRFs generally keep a district's local revenue from growing. Until a district reaches the 20-mill floor it cannot realize inflationary growth in property values, and thereby recoup what the state's formula has assumed as part of the local contribution towards the cost of education, unless it revisits the ballot and receives voter approval for a higher millage rate. High ballot frequency has been a common complaint from school districts of Ohio's system for funding its schools.

This issue was partially addressed in the state's funding formula through the use of "recognized valuation" to calculate the charge-off, which phases in the valuation increase when a district undergoes a reappraisal or update.

"Gap aid" phantom revenue occurs when a district's overall local revenue is less than the local contribution assumed in the state's funding formula, apart from dynamic changes in property reappraisal. A district that levies only 20 mills of taxes and does not have any other type of property or income tax revenue would be subject to the "gap aid" phantom revenue problem. The state at one time addressed this "gap" through a program called the charge-off supplement, or "gap aid" (discussed below under Guarantees and Protection Mechanisms).

IV. How much does education cost?

Cost of education – Local contribution = State funding for education

The cost of education in a foundation formula, often called the "adequacy amount," guarantees the level of financial support, through both state and local contributions, necessary to provide every student with a high quality education. Ohio's foundation program is set forth in law by the State Legislature, and since it was first enacted in 1935, has evolved over the years into a complex and comprehensive formula with the goal of providing the resources necessary for every student to receive a high quality education.

The cost of education is defined by first identifying the strategies needed to provide a quality education, assigning costs to those strategies, and then assembling them into a funding system that can be practically implemented; this process is known as "costing-out" education. There are four recognized approaches to costing-out studies: the successful schools model, the professional judgment model, the evidence-based model and the econometric model.[5]

Most school finance experts agree that funding levels alone are not a panacea for education reform, and that the accountability surrounding a formula is just as critical as the funding itself. Prior to the DeRolph rulings (discussed below), Ohio's school funding system evolved gradually through the years. However, by the late 1980's, Ohio's education community began to rethink its financing structure, most notably through the Gillmor Commission which proposed in its 1989 report new ways to improve the adequacy, equity and stability of school funding in Ohio.

School Finance Litigation – DeRolph v. Ohio

A national wave of school finance litigation began in 1971 when the California Supreme Court ruled its state school funding system unconstitutional in *Serrano v. Priest*. Ohio's own history of school finance litigation, which since 1991 has centered on the case of *DeRolph v. State*, similarly led the Ohio Supreme Court to declare the state's education funding system unconstitutional based on Article VI Section 2 of the Ohio Constitution:

> *"The General Assembly shall make such provisions, by taxation or otherwise, as, with the income arising from the school trust fund,* ***will secure a thorough and efficient system of common schools throughout the state****; but no religious or other sect, or sects, shall ever have any exclusive right to, or control of, any part of the school funds of this state."*

The Supreme Court identified four unconstitutional features of Ohio's system of funding for education, the most significant of which was a foundation program with insufficient funds for an adequate education and which placed too much reliance on local property taxes. Though the other three elements, related to school facilities, the borrowing authority of local districts and emergency school assistance loans, were largely addressed in the late 1990's, the debate continued over how to resolve the concerns of equity and adequacy.

Successful Schools Model

In response to the Supreme Court's DeRolph I ruling in March 1997, Gov. George Voinovich convened the Ohio School Funding Task Force to address the issues raised by the case. The Task Force hired school funding consultant John Augenblick to develop a new way to determine what resources were necessary for the state to provide the quality of education mandated by the Court. Building on his prior work with the Panel of Experts (convened in 1994-1995 by State Superintendent of Public Instruction Ted Sanders), Augenblick proposed a "successful schools" model for determining the base cost of an adequate education, which analyzed the spending of academically successful districts and postulated that all districts could perform similarly at that level of funding.

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[5] Successful schools model – links the funding for every district to the average expenditures of successful districts
Professional judgment model – funds an educational program that is assembled by the advice of education experts
Evidence-based model – identifies individual strategies proven to impact student achievement and combines them into a funding system with other necessary costs
Econometric model – uses detailed data to identify how certain expenditures in districts drive student success

The General Assembly adopted a model similar to what Augenblick proposed through H.B. 650, which instituted a per-pupil amount used for calculating the basic cost of education for FY 1999 and for future years. H.B. 650 identified a base per-pupil cost of $4,063 for FY 1999, which increased yearly to $4,665 for FY 2004. It phased in this new model at $3,851 for FY 1999 and planned to fully fund the formula by FY 2002. The bill also changed the funding mechanism for supplemental programs such as special education and career technical education from a unit-based system to a weighted system, compatible with the new per-pupil amounts.

Of special note: H.B. 650 also established the Committee to Reexamine the Cost of an Adequate Education to "determine the base cost amount and review the methodology used to determine the base cost amount for the budget process." This committee was never convened and was eliminated in H.B. 95, the FY 2004-2005 budget bill.

Building Blocks Model

By 2003, it became clear that questions still remained in Ohio about its school funding formula, underscored by three additional rulings by the Supreme Court in the DeRolph case. To answer these questions, Gov. Bob Taft appointed the Blue Ribbon Task Force on Financing Student Success, which issued a report in 2005 that proposed a revised "building blocks" model for school funding.

Building Blocks	FY 2006	Comments
Base Classroom Teachers	$2,684	Based on teacher salary level of $53,680 in FY 2006 and a student/ teacher ratio of 20:1
Other Personnel Support	1,807	Components increased by projected inflationary measure for the GDP deflator (all items) of 1.8 percent for FY 2007
Nonpersonnel Support	792	
Base Cost Amount	**$5,283**	

The building blocks model moved from an "outcomes" based approach to one constructed from "inputs," defining the basic needs of an educational program and using average district expenses in Ohio to calculate their costs. The model, adopted in H.B. 66 for FY 2006-2007, also included "add-ons" of $40 per pupil to fund intervention, professional development and data-based decision-making.

The Task Force further endorsed a principle that marked a departure from the successful schools approach and anticipated the evidence-based approach: funding systems should be grounded on evidence-based strategies with a proven track record.[6] The Task Force also reinforced and greater emphasized that the resource needs of students will diverge, and that students most in need should receive more resources.

Evidence-Based Model

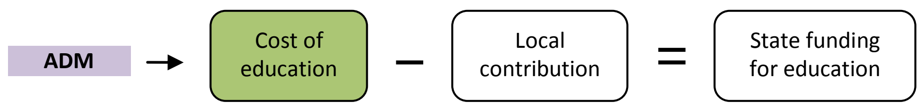
In 2009, Gov. Ted Strickland introduced a new school funding formula in his executive budget, developed using the evidence-based approach. This proposal clearly built on the building blocks model, but went further in specifying the educational strategies included in the model, and swept in many elements that had previously been addressed by separate programs (e.g. poverty-based assistance) to attempt to create a generally comprehensive funding system. The proposal was not limited to school funding reform, and was accompanied by a revised system of teacher licensure, updated academic

[6] Recommendation 6. Report from the Governor's Blue Ribbon Task Force on Financing Student Success in the State of Ohio. Columbus, Ohio. February 2005. Pg. 30.

content standards and a new graduation assessment. After a contentious legislative session the model was adopted in H.B. 1, the FY 2010-2011 operating budget, though it is designed to be phased in through 2019. H.B. 1 also established the School Funding Advisory Council to review the new funding model, and gave the Council Dec. 1, 2010 as the deadline for its report. *More detailed information on Ohio's new evidence-based model will be addressed in subsequent briefings.*

V. What other issues affect the school funding formula?

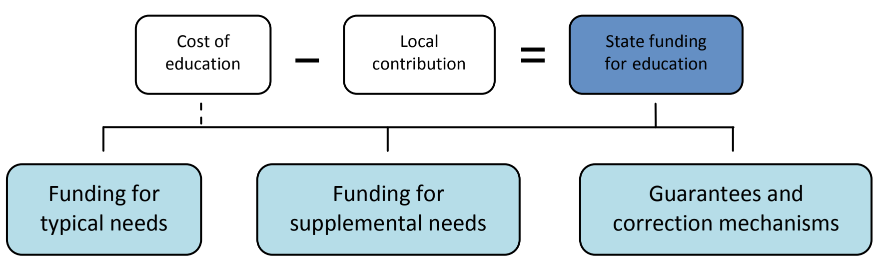
How Students Are Counted



The number of students a district educates, known as Average Daily Membership (ADM), is the most powerful factor influencing the district's cost of education. Ohio counts students in the districts in which they live and makes transfer payments to other districts and schools to accommodate school choice options, such as open enrollment and community schools. In some systems, students are counted where they are educated, which has a different bottom-line impact on the funds school districts receive in comparison to a transfer payment system.

Students are counted for ADM purposes in the first week of October. To increase the stability of the overall funding formula, H.B. 1 initiated the use of the prior year's ADM figure in the education cost calculation. This allows schools to more accurately project their state funding in the coming year for budgetary purposes, and includes an exception for high-growth districts.

Additional Funding Programs



Supplemental Programs

The basic cost of an education has historically focused only on the cost of the typical needs of students without supplemental educational challenges. Supplemental funding for students that required additional resources to meet their educational needs was then added after the charge-off. Examples of students in need of supplemental resources include special education students, limited English students, gifted students, and students in economically disadvantaged environments. The table below shows the percentages of students with supplemental needs. Note that the same student can be identified under multiple categories of supplemental programs.

Under the evidence-based model, most supplement funding elements have been included the education cost calculation before the charge-off is applied. Currently the only programs funded after the charge-off are career technical education and transportation (though other programs not considered a part of the school funding formula are also funded independently through the Department of Education). Transportation is funded as a supplemental program to ensure that all districts receive some support. A new transportation formula included in H.B. 1 is designed to be fairer, to reward efficiency and to better align state funding with level of transportation services provided.

Percentage of Ohio students identified as:	***%***
Special Education	14.8
Limited English Proficient	2.1
Economically Disadvantaged	32.8
Gifted	16.1

Guarantees and Protection Mechanisms

Throughout revisions in Ohio's funding model, temporary mechanisms have been built in to buffer significant changes in the formula and provide districts time to adapt to policy shifts. Transitional aid guarantees ensure no district receives less in overall funding than a certain percentage of what they received in the prior year. Also, the charge-off supplement (commonly referred to as "gap aid") previously provided an additional payment to districts whose local revenue was less than the dollar amount assumed for the district's local contribution (see the Phantom Revenue section). Gap aid, however, created a disincentive for districts to raise local ballot initiatives since every local dollar raised (until the charge-off millage rate was reached) resulted in a proportionate loss of gap aid funding. The program was eliminated in H.B. 1 when the charge-off was lowered, thereby setting the formula on a path to resolve the phantom revenue problem.

VI. Summary

This document provides an overview of the challenges Ohio faces in developing a funding system that will provide a level of state support which, when combined with local resources, allows districts to meet the distinct needs of their students. As the School Funding Advisory Council embarks on its charge to study and recommend changes to the state's current funding system, it is important to ground the discussion in a thorough understanding of the unique realities of Ohio's school funding landscape. Many of these concepts may need to be revisited as the Council hones its focus more intently on its direct goals. ODE staff will continue to provide background materials on issues related to the Council's areas of inquiry, and can help answer any questions you may have or provide you with additional information and resources on request.