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R-131-3462

November 15, 2016

The Honorable Andrew O. Brenner  
Ohio House of Representatives  
Statehouse  
Columbus, OH 43215

Dear Representative Brenner:

You requested a bill draft, L-131-2626, and joint resolution, LR-131-0243, to revise the state's system of funding primary and secondary education and make other related changes. This letter provides some supplementary information about these requests, beginning with a brief summary of the major elements of your funding plan and followed by the information you requested concerning the current streams of funding for K-12 education in Ohio and the amount of outstanding debt held by school districts. The letter concludes with a brief analysis of your proposed changes to Ohio's system of school funding.

## Summary of bill draft and joint resolution funding provisions

Your funding plan presents two issues to Ohio voters at the November 2017 general election that would significantly change how Ohio funds its schools: the creation of a state property tax to replace school district property taxes and a constitutional amendment authorizing the state to issue bonds that would pay off outstanding school district bond debt. The following summarizes the main components of your funding plan. If both issues are approved by voters, the bill draft:

- Creates a state property tax beginning in tax year (TY) 2018 to fund primary and secondary education (the state will begin to receive revenue from the tax in 2019 since property taxes are collected a year in arrears);
- Creates the State Education Fund to receive the proceeds of the state property tax and moneys transferred to it and restricts the fund's use to state education aid formula payments;
- Requires GRF transfers to support state education aid formula obligations not backed by the proceeds of the state property tax and lottery profits;

- Prohibits all school district property and income tax levies beginning in TY 2018<sup>1</sup>;
- Discontinues other tax-related payments to school districts, such as tax increment financing (TIF) payments and reimbursements for tax losses arising from the phase-out of general business tangible personal property and public utility deregulation;
- Abolishes the School Facilities Commission (SFC); transfers its powers, duties, and staff, with respect to in-progress, state-funded school building projects, to the Ohio Facilities Construction Commission; and prohibits any additional school building project from being approved for state funding under any of SFC's programs, effective January 1, 2019;
- Centralizes the school funding system so that most nonfederal school district operating and capital revenue is derived from the proceeds of the state property tax, lottery profits, and GRF revenues and is distributed through the state education aid formula, effective January 1, 2019;
- Replaces district-operated pupil transportation systems with countywide pupil transportation systems overseen by educational service centers (ESCs), effective January 1, 2019;
- Provides state education aid to a student to attend any Ohio public or chartered nonpublic school of their choice and, consequently, eliminates open enrollment, all state scholarship programs, and other state funding programs for chartered nonpublic schools. However, these provisions are delayed until July 1, 2019, to avoid disruption in the middle of the 2018-2019 school year.

The joint resolution amends the Ohio Constitution to authorize the issuance of general obligation bonds, maturing over 20 years, to refund pending bond debt of school districts and to waive the requirement that schools levy property tax to pay debt service. If the voters reject either the state property tax or the constitutional amendment, the current school funding system remains in effect.

Note the bill draft's January 1, 2019, effective date for its funding provisions. While it falls in the middle of fiscal year (FY) 2019, it resolves timing issues created by the different calendars used for tax years and state and school fiscal years. Tax years are generally from January 1 to December 31, whereas state and school fiscal years are from July 1 to June 30. If the funding provisions became effective July 1, 2019 (the start of FY 2020), school districts would forego six months of local property tax revenue before

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<sup>1</sup> The bill draft continues to allow a school district to serve as the taxing authority for a "school district public library," a type of public library that shares the territory of the school district in which it is located. No public library system has the independent power to levy taxes. Their source of local tax funding is the taxing authority of a political subdivision. In this case, a school district board levies the tax on the taxable property of the district. However, the proceeds are paid to the treasurer of the board of library trustees.

the new funding system begins. A January 1, 2019, effective date implements the new funding system as local property tax collections cease.

## Current K-12 education funding

Your funding plan intends to limit K-12 education funding to the amount currently received from certain state and local sources. These sources total to an estimated \$20.37 billion in FY 2017. Table 1 below illustrates the composition of these funds. Overall, state sources comprise \$10.25 billion (50.3%). Of this amount, \$8.10 billion (79.0%) provides state foundation aid (including funding for community and science, technology, engineering, and mathematics (STEM) schools and scholarships financed by transfers from the student's resident district), with most of the remainder designated for property tax relief (\$1.20 billion, 11.7%), school facilities (\$337.5 million, 3.3%), property tax reimbursements and the TPP supplement (collectively \$288.7 million, 2.8%), and funding for chartered nonpublic school auxiliary services and administrative costs (collectively \$215.0 million, 2.1%). Local revenues produce the remainder of the total, \$10.11 billion (49.7%). Local revenues are comprised of property taxes (95.9%, excluding the portion of property taxes paid by the state) and school district income taxes (4.1%).

<b>Table 1. Selected State and Local Sources for K-12 Education Funding, FY 2017</b>		
<b>Source Components</b>	<b>Amount (in millions)</b>	<b>Percentage of Source</b>
<b>State Sources</b>		
Foundation formula	\$8,103.8	79.0%
Property tax relief	\$1,201.3	11.7%
School facilities assistance (capital)*	\$337.5	3.3%
TPP direct reimbursements	\$245.9	2.4%
Auxiliary services for chartered nonpublic schools	\$147.3	1.4%
Directly funded scholarships	\$69.5	0.7%
Nonpublic administrative cost reimbursement	\$67.7	0.7%
TPP supplement	\$42.8	0.4%
Half-mill maintenance equalization	\$19.3	0.2%
Community school facilities	\$16.8	0.2%
Community school performance bonuses	\$1.8	< 0.1%
<b>Total state sources</b>	<b>\$10,253.8</b>	<b>100.0%</b>
<b>Local Sources</b>		
Property taxes	\$9,703.8	95.9%
Income taxes (FY 2016)	\$410.4	4.1%
<b>Total local sources</b>	<b>\$10,114.3</b>	<b>100.0%</b>
<b>Total all sources</b>	<b>\$20,368.0</b>	

\* School facilities assistance represents one-half of the applicable capital appropriations for the FY 2017-FY 2018 capital biennium.

Table 2 below displays current school district property tax collections in more detail. As the table shows, traditional and joint vocational school districts levied a total \$10.91 billion in property taxes for TY 2015, which, due to the different calendars for tax years and state fiscal years, generally corresponds to the state's FY 2017. Most of these taxes, \$9.57 billion (87.8%), were levied for operating purposes. The remainder was levied primarily to pay the debt service on outstanding school district bonds. Of the total amount levied, the state will pay \$1.20 billion in FY 2017 to provide property tax relief under the 10% and 2.5% property tax "rollbacks" and the Homestead Exemption Program for the elderly and disabled.

<b>Levy Purpose</b>	<b>Amount (in millions)</b>	<b>Percentage of Source</b>
Current expense (operating)	\$9,573.7	87.8%
Debt service	\$992.8	9.1%
Permanent improvements	\$331.6	3.0%
Other	\$7.1	0.1%
<b>Property tax subtotal</b>	<b>\$10,905.2</b>	<b>100.0%</b>
State-paid property taxes	\$1,201.3	
<b>Locally paid property taxes</b>	<b>\$9,703.8</b>	

### **School district bond debt**

You requested information on the amount of outstanding debt held by school districts. School districts owed \$10.23 billion as of the end of FY 2014, the latest available data.<sup>2</sup> This amount is projected to grow to \$11.99 billion by the end of FY 2017 based on a trend analysis of the outstanding debt reported each year from FY 2011 through FY 2014. Under your proposal, the state would issue general obligation bonds to pay off this debt, with the annual debt service paid from the proposed target amount of \$20.37 billion for K-12 education. The annual debt service on the state bonds is estimated at \$848.1 million based upon the average 20-year municipal bond rate for AAA rated municipal bonds, as of October 6, 2016, plus 1%, for a total of 3.56%.<sup>3</sup>

<sup>2</sup> U.S. Census Bureau, 2014 Survey of School System Finances, Table 10. Indebtedness and Debt Transactions of Public Elementary-Secondary School Systems by State, accessible online at [http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=SSF\\_2014\\_00A10&prodType=table](http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=SSF_2014_00A10&prodType=table).

<sup>3</sup> [http://finance.yahoo.com/bonds/composite\\_bond\\_rates?bypass=true](http://finance.yahoo.com/bonds/composite_bond_rates?bypass=true). One per cent was added to the October 6, 2016, rate to ensure sufficient resources are available to pay the debt service should municipal bond rates rise in the future.

## Analysis of proposed K-12 education funding model

### State property tax revenue and GRF transfers

The bill draft levies the state property tax at a gross rate of 38.6 mills. When applied to TY 2015 statewide total taxable value of \$248.34 billion, this rate raises \$9.59 billion, about the same amount of revenue generated by school district current expense levies for TY 2015. Based on FY 2017 foundation formula appropriations, lottery profits contribute an additional \$1.06 billion to the plan, leaving the GRF to support the balance, \$9.72 billion (see Table 3 below). In FY 2017, the GRF and commercial activity tax receipts dedicated to TPP direct reimbursements<sup>4</sup> fund \$8.67 billion of the \$20.37 billion target amount. An additional \$1.05 billion from the GRF would need to be allocated to K-12 education to fully fund your proposal.

<b>Source</b>	<b>Amount (in millions)</b>	<b>Percentage of Total</b>
State property tax	\$9,585.9	47.1%
Lottery profits	\$1,059.5	5.2%
<b>Dedicated sources subtotal</b>	<b>\$10,645.4</b>	<b>52.3%</b>
Remainder - GRF transfers	\$9,722.6	47.7%
<b>Total</b>	<b>\$20,368.0</b>	<b>100.0%</b>

State property tax revenue will likely grow in future years, but not at the same rate as property values grow. The state property tax is subject to tax reduction factors, a tax policy enshrined in the Ohio Constitution that limits tax revenue growth on existing real property. When the value of existing real property increases, tax reduction factors reduce the effective tax rate so tax revenue on that property remains the same. However, tax reduction factors do not apply to new construction and tangible property; taxes on these two types of property will grow at the same rate property values grow. Thus, a 5.0% increase in real property value will generally lead to a much smaller increase (1.0%, for example) in real property tax revenue for the state.

If, over time, the state effective tax rate falls below 20 mills, tax reduction factors will continue to apply, unlike current law with respect to certain school district property tax levies. The bill draft, in prohibiting school district property taxes, eliminates the "20-mill floor" without enacting a similar provision for the state property tax.<sup>5</sup>

<sup>4</sup> The bill draft redirects to the GRF the portion of CAT receipts dedicated to funding the reimbursements.

<sup>5</sup> The 20-mill floor refers to a provision of current law that prohibits a school district's combined real property millage from current expense levies and inside mills for operating expenses from falling below 20 effective mills. Once the combined real property millage falls to 20 effective mills, tax reduction factors no longer apply. Real property taxes based on these 20 mills will grow at the same rate as real property values grow.

## State education aid distribution

Your funding plan replaces the current state-local school funding system with a centralized system in which a state property tax, lottery profits, and GRF funds provide most nonfederal school district operating and capital funding. The plan largely retains the current formula used to distribute state foundation aid but removes or changes some key elements. Among the major changes, your plan:

- Eliminates the state share index since the state no longer needs to equalize payments based upon district capacity to raise local revenues;
- Eliminates targeted assistance and capacity aid, two other components tied to the variation in school district capacity;
- Removes funding guarantees and gain caps so that funding is consistent with the number of students served;
- Replaces district-operated pupil transportation systems with countywide pupil transportation systems overseen by ESCs;
- Funds community and STEM schools directly rather than through transfers of state aid from the students' resident districts;
- Limits the opportunity grant payment for an e-school student to 60% of the per-pupil formula amount;
- Permits community and STEM schools (both site-based and e-schools) to receive gifted identification and unit funding and e-schools to receive per-pupil categorical funding for students who are limited English proficient, economically disadvantaged, and in grades K-3 (current law excludes such schools from these funding components);
- Allows state education aid to fund students educated in the public or chartered nonpublic school of their choice and, accordingly, eliminates open enrollment, all state scholarship programs, and auxiliary services and nonpublic administrative cost reimbursement payments for chartered nonpublic schools;
- Abolishes SFC and prohibits any additional school building project from being approved for state funding under any of SFC's programs;
- Adjusts the per-pupil formula amount to spend about the same amount of money as the \$20.37 billion currently raised from the major state and local sources described in Table 1 above (the "target" amount).

We simulated the effects of your funding plan on FY 2017 to determine the per-pupil formula amount and to compare its distribution with current law, controlling for the transfers of traditional school district state aid for community and STEM schools and scholarship programs. We subtracted pupil transportation and debt service costs

from the target amount, since these costs appear to be paid outside the main formula.<sup>6</sup> This leaves \$18.62 billion for main formula payments for students attending traditional and joint vocational school districts, community schools, and chartered nonpublic schools. The proposed formula yields a per-pupil formula amount of \$8,740 (in comparison, the current per-pupil formula amount is \$6,000). Per-pupil categorical amounts are unchanged from current law. In addition, we assume current public and chartered nonpublic students remain in their educating districts or schools since we are uncertain about where students will attend school under your proposal. Actual results may vary significantly as students and parents make use of the plan's expanded school choice provisions. Table 4 below compares our simulation of your proposal to estimated K-12 education funding for FY 2017 under current law.

<b>School Type/Category</b>	<b>Current Law</b>	<b>Proposed</b>	<b>Difference</b>	<b>% Change</b>
Traditional districts (less transportation and debt service)	\$16,369.4	\$15,506.8	-\$862.6	-5.3%
Joint vocational school districts	\$654.7	\$510.3	-\$144.4	-22.1%
Community and STEM schools	\$969.9	\$1,096.3	\$126.3	13.0%
Chartered nonpublic schools	\$480.4	\$1,504.2	\$1,023.8	213.1%
Transportation	\$900.8	\$900.8	\$0	0.0%
Debt service on school district bonds	\$992.8	\$848.1	-\$144.7	-14.6%
<b>Total</b>	<b>\$20,368.0</b>	<b>\$20,366.4</b>	<b>-\$1.6</b>	<b>&lt; -0.1%</b>

As Table 4 shows, funding for chartered nonpublic students is projected to be \$1.50 billion under your plan, assuming all 172,000 or so students currently attending a chartered nonpublic school will be introduced into the state funding system. This amount likely understates state payments for these students, as, due to data limitations, it is based only on the funding generated by the per-pupil formula amount. Actual funding may be greater because such students will be supported by additional per-pupil amounts if they are identified as disabled, economically disadvantaged, limited English proficient, in grades K-3, and so on. Nevertheless, the projected funding for chartered nonpublic students represents an increase of \$1.02 billion from current state funding of \$480.4 million for FY 2017, which includes payments for auxiliary services and nonpublic administrative cost reimbursements (totaling \$215.0 million) and all scholarship programs (\$265.3 million).

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<sup>6</sup> The bill draft pays the pupil transportation amounts calculated for school districts under the existing transportation formula, without the state share index applied, to the ESC that serves the county in which a majority of the district is located. Thus, we assume, in both current law and the proposal, total transportation funding to be equal to the formula-calculated costs for Type I (board-owned and operated school buses) and Type II (contractor-owned and operated school buses) transportation plus formula costs for other types of transportation, payments to community schools transporting their own students, and the current formula's transportation supplement. These amounts total to \$900.8 million in FY 2017.

The increase in payments for chartered nonpublic students is balanced by a substantial reduction in funding for public districts. After controlling for transportation and debt service, proposed traditional school district funding is \$862.6 million (5.3%) less than current law because of the influx of new students in the state funding system. Likewise, funding for joint vocational school districts decreases \$144.4 million (22.1%). Further, without a separate funding stream for school facilities assistance, it appears that school districts will also need to pay for future capital needs out of the resources distributed through the state education aid formula, likely delaying the completion of many school building projects.

Due to the large loss of funding for traditional school districts, you may be interested in a scenario where the target amount excludes the funding for chartered nonpublic students, leaving the \$18.62 billion in formula funding for students attending traditional and joint vocational school districts and community and STEM schools. This scenario allows the formula amount to increase from \$8,740 to \$9,630. Table 5 below illustrates the differences in funding compared to current law. As the table shows, traditional district funding in this scenario is \$517.3 million (3.2%) greater than current law. Payments for students attending chartered nonpublic schools would need to be funded separately at a cost of about \$1.66 billion.

<b>School Type/Category</b>	<b>Current Law</b>	<b>Proposed</b>	<b>Difference</b>	<b>% Change</b>
Traditional districts (less transportation and debt service)	\$16,369.4	\$16,886.7	\$517.3	3.2%
Joint vocational school districts	\$654.7	\$544.7	-\$110.0	-16.8%
Community and STEM schools	\$969.9	\$1,187.1	\$217.2	22.4%
Chartered nonpublic schools	\$480.4	\$0	-\$480.4	-100.0%
Transportation	\$900.8	\$900.8	\$0	0.0%
Debt service on school district bonds	\$992.8	\$848.1	-\$144.7	-14.6%
<b>Subtotal</b>	<b>\$20,368.0</b>	<b>\$20,367.4</b>	<b>-\$0.6</b>	<b>&lt; -0.1%</b>
Cost for chartered nonpublic school students	\$0	\$1,657.3	\$1,657.3	N/A
<b>Total</b>	<b>\$20,368.0</b>	<b>\$22,024.7</b>	<b>\$1,656.7</b>	<b>8.1%</b>

I hope this information is helpful to you. Please contact me at (614) 466-8742 or [Jason.Glover@lsc.ohio.gov](mailto:Jason.Glover@lsc.ohio.gov) if you have any questions or need additional information.

Sincerely,

*Jason Glover*

Jason Glover  
Budget Analyst

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