

FINAL REPORT

**Levy and Local Effort Assistance
Technical Working Group**

July 12, 2011

Executive Summary

LEVY AND LOCAL EFFORT ASSISTANCE TECHNICAL WORKING GROUP'S LEGISLATIVE CHARGE

In Chapter 548, Laws of 2009 (ESHB 2261) and Chapter 236, Laws of 2010 (SHB 2776), the Legislature established the Levy and Local Effort Assistance Technical Working Group and directed it to:

- Develop options for a new system of K-12 supplemental funding through local school levies and local effort assistance;
- Consider the impact of the new basic education funding system enacted in SHB 2776 on overall school district revenues;
- Recommend a phase in plan that assures no district suffers a decrease in funding due to implementation of the new system of supplemental funding;
- Conduct an analysis on the potential use of local funds that may become available for redeployment and redirection as a result of increased state funding allocations for pupil transportation and maintenance, supplies and operating costs (MSOC); and
- Examine local school district capacity to address facility needs associated with phasing in full-day kindergarten and K-3 class size reductions.

KEY OBSERVATIONS AND RECOMMENDATIONS ON LEVY AUTHORITY

Several themes emerged in the Working Group's analysis of the current levy system and potential alternatives. The Working Group's key observations and recommendations are:

- **Levies are a core component of community support for schools and provide an opportunity for communities to fund their priorities and affirm their support for education.** Along with school board elections, maintenance and operation, or M&O, levy elections are an important accountability mechanism for voters.
- While they are an important component of total school funding, local levies do not diminish the critical need for state support for schools. **The Working Group is concerned that legislated increases in levy authority not be used to erode essential financial state support for schools.**
- **All districts should retain the ability to levy, at minimum, the amount permissible under current law.**
- **Levy authority appropriate to economic conditions during periods of state and federal funding reductions should be maintained.** The Legislature should continue this well-established precedent. Without the maintenance of local authority, significant budget reductions would occur at the district level. (There are a number of mechanisms to

accomplish this, such as use of the per pupil inflator adjustment (PPI), a levy lid lift or modification of the levy base).

- **As funding inequities were noted between neighboring districts, the number of grandfathered districts should be reduced and eventually eliminated by increasing levy authority of the non-grandfathered districts over time.** Fundamental to this goal is continuation of state levy equalization.
- **Increasing levy authority to eliminate grandfathering will help only those communities able to access additional revenue from increased authority.** A number of districts, such as Yakima, cannot access their current levy authority; therefore an increase in authority will provide no benefit to the programs and services in these districts.
- **Levy and levy equalization calculations and formulas should continue to recognize the needs of small schools.**

RECOMMENDATIONS AND OBSERVATIONS ON LEVY EQUALIZATION

The Working Group's major observations and recommendations on levy equalization are:

- **The strong reaffirmation of levy equalization as a necessary tax equity program.** It mitigates the effect of above-average property tax rates on a school district's ability to raise local funds. It also serves to provide property tax relief to taxpayers in districts with above-average property tax rates. The Working Group recommends continuing the program as it is critical to the local funding system.
- **The strong reaffirmation of the current policy of 50 percent levy equalization, which it views as the floor for equalization funding.** As such, each of the levy options considered in the report assume a 50 percent levy equalization construct, at a minimum.
- **A goal of providing more equalization over time, up to full equalization as the Legislature increases state support for core programs.**
- **The rejection of reductions or modifications to the levy equalization formula, such as pro-rating or applying tiered cuts to the formula.**

LEVY AND LEVY EQUALIZATION BACKGROUND

Under Washington state law, K-12 school districts may levy local property taxes for up to four years at a time for school maintenance and operations (M&O) levies, upon simple majority approval by local voters. Of the state's 295 school districts, 281 districts have voter-approved levies. In the 2009–10 school year, M&O levies comprised about 16 percent of total school district operating revenues statewide. These levies are in addition to the funds districts receive from the state and federal governments.

The Washington State Constitution establishes the education of all children as the paramount duty of the state. It requires the state to make ample provision for a uniform system of public schools. As a result of this constitutional mandate, Washington provides the majority of operating funds for local school districts. During the 2009 and 2010 legislative sessions, the Legislature adopted a revised system of state funding for schools. The legislative updates to the state funding formulas for schools also raised issues about the current system of local supplemental levy funding and the state's Local Effort Assistance program. Accordingly, the Legislature created the Levy and Local Effort Assistance Technical Working Group to develop options for a new system of K-12 supplemental funding through local levies and local effort assistance.

Prior to 1977, local M&O levies comprised as much as 30 percent of school district operating revenues statewide. During the economic recession of the 1970s, several districts, including Seattle, experienced levy failures. This launched a series of events in K-12 fiscal policy. The first was the lawsuit and subsequent Supreme Court affirmation of the Judge Doran decision in *Seattle v. State*, also known as Doran I, in which the courts directed the Legislature to define and then fund a program of basic education through stable funding sources, having ruled that local levies were not a stable source of school revenue. In 1977, the Legislature followed the decision with the dual enactment of the Basic Education Act and the levy lid law. The Basic Education Act resulted in significant increases in state funding for school districts while the levy lid law resulted in reductions in local property tax levies for districts. The end result of both was a notable shift from local to state funding of public schools.

Local Levy Authority

The levy lid law caps the amount of local M&O levy a school district can collect. Each school district's levy authority is limited to a set percentage (the levy lid) of the state-defined levy base. An individual district's levy base for any tax year is a composite of the district's prior year's state and federal revenues, adjusted by inflation and other factors. Under current law, the levy lid is 28 percent of the levy base for all districts. However, 90 districts are grandfathered at higher levy lid percentages ranging from 28 to 37 percent. Differences in each district's state and federal revenue base, in addition to the grandfathered levy lids, lead to significant variations in the maximum levy authority of school districts when levy authority is viewed on a dollar-per-pupil basis. These differences have led some to question and express concern for local funding equity across school districts.

Levy Equalization

A district's M&O levy property tax rate, expressed as \$1.00 of property tax for every \$1,000 of assessed value, is dependent on two factors:

- the size of the district's assessed value of all taxable properties within the district, and
- the size of its voter-approved M&O levy, up to the district's levy limit.

Holding the size of the levies constant, taxpayers in districts will have different tax rates to generate the same amount of revenue: Taxpayers in districts with higher total assessed value pay lower tax rates than taxpayers in districts with lower total assessed value to raise the same amount of revenue. Again, these differences lead to questions and concerns about equity — in this case, the concerns are of taxpayer equity and the corresponding ability of communities to approve levies in support of schools. Beginning in 1989, the state has addressed taxpayer equity concerns by providing state-funded levy equalization, or local effort assistance, funds to districts with above-average property tax rates.

The Working Group affirms levy equalization as an important component of the local levy system as it provides both property tax relief and mitigates the effect that above-average property tax rates have on districts' ability to raise local revenues. The original intent of levy equalization was to provide property tax relief. The Working Group reaffirms this intent. Further, the Working Group asserts that the state should establish a goal of equalizing 100 percent of the total amount levied.

To receive levy equalization funds, voters in a school district must pass a local M&O levy. In calendar year 2011, under a levy lid of 28 percent, the state equalizes tax rates for a 14 percent levy (the first 50 percent of a district's levy lid before grandfathering).

State funds allocated to districts for levy equalization are in lieu of local property tax collections. The district receives equalization funding from the state, instead of the local taxpayers, and the taxpayers pay a lower annual tax bill for their locally approved levy. If a district receives levy equalization, the state deducts that amount from the total the district is authorized to collect in property taxes.

State equalization of the first 50 percent of a district's levy authority is referred to as "partial equalization." Because levies are partially equalized, taxpayers in levy equalization districts still pay higher property tax rates, on average, than those in districts without equalization. The report describes both district-level tax rates and tax payments in detail. The Working Group also analyzed M&O levy tax bills in the context of districts' median family incomes. On average, taxpayers in lower property value districts pay a higher percentage of their incomes for local levy payments. Levy equalization tends to reduce this disparity.

LEVY AUTHORITY OPTIONS

The Legislature requested options for a program of local supplemental funding. The expertise and perspectives of Working Group members allowed a thorough exploration, technical vetting and debate of a variety of policy options. The report provides a summary of each major option developed or reviewed by the Working Group, with analysis of the merits and pitfalls of each.

The Working Group's options detailed in this report center on two different assumptions of state funding. Options 1 and 2 are based on state funding allocations as provided in the 2011-13 biennium, while Options 3 and 4 are based on specific enhancements to state funding.

LEVY AUTHORITY OPTIONS 1 AND 2 — BASED ON STATE FUNDING ALLOCATIONS AS PROVIDED IN THE 2011–13 BIENNIUM

While the Working Group developed options for consideration through a consensus-based process, members *did not achieve a consensus recommendation on Option 1 (retaining the current structure), versus Option 2 (changing authority to per-pupil concept)*. The report details its discussions as well as provides recommendations specific to each option for legislative consideration.

- **Authority Option 1:** Retain the Current Levy Structure with Some Modifications
- **Authority Option 2:** Change Local Levy Authority to Per-Pupil Funding Concept

The Working Group recognizes the current levy structure includes several unresolved issues from the 1970s, primarily due to grandfathering. The inclusion of a per-pupil model attempts to resolve some of these issues. However, the Working Group recognizes a per-pupil model creates new questions and policy issues that must be addressed if the model is considered by the Quality Education Council and the Legislature.

THE WORKING GROUP MAKES THE FOLLOWING RECOMMENDATIONS, REGARDLESS OF OPTION 1 OR 2:

- **The number of grandfathered districts should be reduced and eventually eliminated by increasing levy authority of the non-grandfathered districts over time.** Fundamental to this goal is continuation of state levy equalization.
- **Levy authority should be maintained appropriate to economic conditions during periods of state and federal funding reductions.** The Legislature should continue this well-established precedent. The consequence of legislative inaction is significant budget reductions at the local level. (The Working Group notes a number of mechanisms to accomplish this, such as use of the per-pupil-inflator adjustment (PPI), a levy lid lift or modification of the levy base).
- **Alternatively, if a per-pupil model is considered, the per-pupil amount should be high enough to resolve some inequities currently caused by grandfathered levy lids.**
- **No district should lose levy authority,** which would result in on-the-ground budget reductions.
- **Careful consideration should be given to levy equalization impacts** to ensure districts do not lose levy equalization funds due a formula change (as opposed to normal shifts due to changes in total assessed value).

- **Levy and levy equalization calculations and formulas should continue to recognize the needs of small schools.**

LEVY AUTHORITY OPTIONS 3 AND 4 — BASED ON ENHANCED STATE ALLOCATIONS FOR MATERIALS, SUPPLIES AND OPERATING COSTS (MSOC) AND PUPIL TRANSPORTATION

Part of the legislative charge was to consider the impact of the new basic education funding system enacted in SHB 2776 on overall school district revenues. Option 3 (enhanced state funding and levy authority) and Option 4 (state and local property tax shift) are crafted under the assumption of increased state allocations for MSOC and pupil transportation.

- **Authority Option 3:** Enhanced State Funding and Local Levy Authority
- **Authority Option 4:** A Local and State Property Tax Shift

With regard to Options 3 and 4 on enhanced state funding, the Working Group determined it was premature to specify or recommend a specific adjustment to local levy authority based on three compelling factors:

- A new state compensation working group will convene after this report is submitted to the Legislature. Compensation accounts for a significant share of school district expenditures. Any substantive compensation changes will dramatically affect the needs and uses of local levy funds.
- The Legislature’s phase in of enhanced funding for SHB 2776 is still to be determined.
- Operating costs to the district are projected to increase due to forecasted increases in enrollment, inflation increases and other factors. Further, state and federal budget reductions will limit the amount of revenues available for programs.

OPTION 3 ANALYSIS OF THE IMPACT OF ENHANCED STATE FUNDING ON LOCAL LEVY

AUTHORITY. The Working Group recognizes an increase in state funding would, under the current levy structure, increase local levy authority.

- **At minimum, local levy authority for districts should remain at current levels.** The enhanced funding options address two areas of local funding use: MSOC and pupil transportation. Additionally, the other areas of focus for SHB 2776 are on K-3 class sizes and full-day kindergarten programs. Enhanced state revenues would not offset current budget pressures experienced by districts such as:
 - Operating a high school. This includes the need to provide a comprehensive range of courses and extracurricular activities. Additionally, costs of extracurricular activities will continue to rise due to increases in gas prices, athletic fees and other items.
 - Items negotiated under collective bargaining.
 - Programs for which district operational costs exceed state or federal funding allocations and are not addressed by SHB 2776.

- **Depending on the phase in of SHB 2776 and the compensation package put forth by the Legislature, it could be appropriate for local levy authority to increase by the full amount of new state funding.** As class sizes decrease and full-day kindergarten is phased in, more classrooms and staff will be needed:
 - As more classrooms become operational, MSOC revenues will not increase. Pursuant to the new formula, MSOC is per student, not per teacher. Additional classrooms come with a need for more MSOC, particularly for utilities, insurance and maintenance, and districts will rely on local funds.
 - As class sizes are reduced and new staff members are hired, districts will continue to provide supplemental contracts to new staff, pursuant to collective bargaining agreements. Local levy funds are used to accomplish this.
 - Depending on the phase in and the compensation package put forth by the Legislature, it could be appropriate for local levy authority to increase by the full amount of new state funding. However, it is not prudent to make a recommendation of an amount at this time without additional information.

OPTION 4 WOULD INCREASE STATE ENHANCED FUNDING THROUGH A STATE AND LOCAL PROPERTY TAX SHIFT. While the state property tax would increase, the levy lid would be reduced. Option 4 does not necessarily provide a significant increase in total funding to districts: It shifts the source of revenues from the local district to the state. A hold-harmless is included so no district loses revenue. **A property tax shift is rejected as it could hamstring the ability of local districts to meet current collective bargaining obligations and other education commitments to their communities, even with enhanced state funding.**

LEVY EQUALIZATION OPTIONS CONSIDERED AND VETTED

The Working Group reached consensus on the levy equalization program and the importance of continuing it.

- Option 1: Maintain Current Policy (recommended)
- Option 2: Pro-Rate (not recommended)
- Option 3: Tiered (not recommended)

The Working Group’s major observations and recommendations on levy equalization are:

- **Strong reaffirmation of levy equalization as a necessary tax equity program.**
- **Strong reaffirmation of the current policy of 50 percent levy equalization and considers this to be the floor for equalization funding.**
- **A goal of providing more equalization over time, up to full equalization as the Legislature increases state support for core programs.**
- **Rejection of any reductions to levy equalization or modifications such as pro-rating or applying tiered cuts to the formula.**

POTENTIAL LOSS OF LEVY AUTHORITY

The Working Group was charged with analyzing the potential use of local funds that may become available for redeployment and redirection as a result of increased state funding allocations for pupil transportation and MSOC.

Working Group members are deeply concerned by a series of state and federal funding reductions taken during the 2011–13, 2009–11 and prior biennia. **The Working Group believes the total amount of funding available through state and local sources does not support adequate education services levels.** While they are important funding improvements, scheduled state enhancements to MSOC and transportation will not offset the need for supplemental funding through levies. **The Working Group opposes an application of a dollar-for-dollar reduction to levy authority based on the enhanced MSOC and transportation funds.**

SCHOOL DISTRICT FACILITY CAPACITY FOR PHASING IN FULL-DAY KINDERGARTEN AND K-3 CLASS SIZE CHANGES

The Legislature directed the Working Group to examine local school district capacity to address facility needs associated with phasing in full-day kindergarten and K-3 class size reductions. The Working Group reviewed recent school facility reports, analyses and school district survey results, and described school facility capacity issues and concerns.

Observations and recommendations:

- Comprehensive statewide data on school capacities are not currently available. **There are dangers in extrapolating data, including district and statewide class size and facility capacity averages, into policy statements and options applicable at the individual school level.**
- **Some communities face significant facility capacity issues.** This is not a new issue. **Enrollment increases and programmatic demands are increasing pressure on school facilities.**
- Within districts, facility issues are complex at the individual grade, school and neighborhood levels. Citizens are passionate about their neighborhood schools; **school capacity issues can be among the most challenging issues for school districts to address.**
- Facilities will continue to present barriers to implementing full-day kindergarten and major reductions to K-3 class sizes in some communities. **State funding enhancements for full-day kindergarten and K-3 class size reduction under SHB 2776 were intentionally developed as funding *allocations*, not mandatory program requirements.** It is critical that districts retain flexibility in the use of these allocations, especially given facility capacity constraints and barriers.
- New construction or modification projects are one way to address facility barriers. However, exploration of state and local school construction funding was beyond the scope of the Working Group’s legislative charge.