TXD L 1801.7 H816SEF NO.74-12
8/08/95 8/00
D. L. 0610 32523409
The University of Texas-Pan Am
Texas State Document

May 1995

HOUSE
RESEARCH
ORGANIZATION
session focus
Texas House of Representatives
May 1, 1995

School finance issues remain after ruling

The Texas Supreme Court, in upholding the constitutionality of the current Texas school finance plan in January, warned that its decision "should not be interpreted as a signal that the school finance crisis in Texas has ended." The court said the constitutionality of the school finance system still could be successfully challenged if evidence showed that:

♦ school facilities were not adequately funded,

♦ the state's $1.50 cap on school district tax rates for operations left districts with no meaningful discretion to set their tax rates, or

♦ the state failed to fund the public school system adequately.

The school finance law, established in 1993 in SB 7 by Ratliff (73rd Legislature, regular session), was upheld by the Supreme Court on January 30, 1995. The court denied all motions for rehearing the case on March 2, 1995.

This report reviews the court's decision, the history of the school finance case and the proposals being considered by the 74th Legislature to respond to concerns about state funding of public school facilities.

BACKGROUND

In 1984 the Edgewood Indpendent School District in San Antonio and other property-poor school districts filed a lawsuit challenging the public school finance system in state district court. The Edgewood plaintiffs contended the state system was unconstitutional because it did not efficiently and fairly distribute revenues to school districts. A state district court in Austin ruled in favor of the plaintiffs. The decision was upheld in 1989 by the Texas Supreme Court in *Edgewood ISD v. Kirby (Edgewood I)*. In 1991 a new school finance plan was found unconstitutional by the district court and by the Supreme Court in *Edgewood ISD v. Kirby (Edgewood II)*. The Legislature again revised the school finance system by creating 188 taxing districts called county education districts (CEDs), but in 1991 the Texas Supreme Court found that this new system was unconstitutional, in *Carrollton-Farmer's Brank ISB v. Edgewood ISD (Edgewood III)*.

SB 7, creating the current school finance system, was signed by the governor on May 31, 1993. State District Judge Scott McCown of Austin held that the SB 7 law was constitutional in all respects *except* for its provisions for school facilities. On January 30, 1995, the Supreme Court ruled SB 7 constitutional in all respects, *including* the bill's provision for school facilities, *Edgewood ISD v. Meno (Edgewood IV)*.

The current plan and the district court decision had been attacked in court by groups that the Supreme Court divided into five categories.

♦ Appellants from property-poor districts argued that school funds were not efficiently or fairly distributed.

♦ Appellants from property-rich districts primarily argued that SB 7 unlawfully transferred local tax money to other school districts.

♦ The state argued against the district court's ruling that school facilities were not adequately funded.

♦ The Guadalupe Gutierrez group of appellants argued that students had a right to school vouchers.

♦ The Somerset Independent School District group of appellants complained about the distribution of excess county education district funds.

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How the SB 7 plan works

Public education in Texas is funded by a combination of locally imposed property taxes and state general revenue that is distributed to local districts according to formulas that take into account enrollment and local tax effort, among other things. State aid is distributed in various "tiers." The Available School Fund (ASF), the first level of state school aid, is made up of earnings from the state's education trust fund, the Permanent School Fund (PSF). The ASF provides $367 per student and is distributed on a per capita basis to school districts regardless of district property wealth.

In addition to ASF funds, the state distributes funds to school districts based primarily on each district's property wealth. As in previous school-finance plans, SB 7 distributes state funds through the two-tiered Foundation School Program. In Tier 1 the state guarantees a school district a basic allotment of $2,300 for each student in average daily attendance. The $2,300 is subject to adjustments for districts with special characteristics, e.g. sparsity of students. To be eligible for state aid to reach the basic allotment, a school district must raise its local share (local fund assignment) of Tier 1 funding, defined as the amount produced when the district levies an effective tax rate of $0.86 per $100 property value in the district for the prior tax year. The state makes up any difference so each district gets at least $2,300 per student.

Tier 2 sets up a guaranteed yield program for districts that raise taxes above their local share of funding in Tier 1. For every penny raised above the required tax rate in Tier 1, the state will guarantee a yield of $20.55 per *weighted* student. (Student weighting reflects special needs of a student.) The guaranteed yield program helps property-poor districts that would not otherwise be able to raise $20.55 per penny of tax effort due to the their low property values. The state's yield guarantee applies only to the first $0.64 of tax effort per $100 valuation that goes beyond the $0.86 of effort required in Tier 1. This means that no Tier 2 funds are provided for any effective tax rates exceeding $1.50, the statewide cap on the tax rate a school district may impose.

To reduce the gap between what property-rich districts and property-poor districts may spend on their students, SB 7 caps the local property wealth per student that a property-rich district may tax. School districts with total taxable property wealth exceeding $280,000 per student must share their excess revenue with property-poor districts or face detachment of part of their taxable property or consolidation with a poorer school district. Options for sharing wealth include:

- consolidation with another district;
- detachment of territory;
- purchase of average daily attendance credit;
- contracting for the education of nonresident students; or
- tax base consolidation with another district.

Out of the state's 1,046 school districts, 96 have been required to share local property tax wealth with lower-wealth districts, and most have chosen to use a contract to pay a another district to help educate the poorer district's students.

The court's opinion

The attack on the state's school finance system has centered on Art. 7, sec. 1, of the Texas Constitution. The section states:

> A general diffusion of knowledge being essential to the preservation of the liberties and rights of the people, it shall be the duty of the Legislature of the State to establish and make suitable provision for the support and maintenance of an efficient system of public free schools.

The Supreme Court determined that seven public education goals articulated in SB 7 had been met; that children who live in property-poor districts and children who live in property-rich districts now have substantially equal access to funds necessary for the general diffusion of knowledge; and that the Texas school finance system was therefore constitutionally efficient.

Justice Cornyn delivered the court's opinion, in which Chief Justice Phillips and Justices Gonzalez, Hightower and Gammage joined. Justice Hecht, agreeing with property-rich district arguments, filed an opinion concurring in part and dissenting in part, which Justice Owen joined. Justice Enoch, also agreeing with some of the property-rich districts' arguments, filed an opinion concurring in part and dissenting in part. Justice Spector agreed with arguments made by property-poor districts and filed a dissenting opinion.

The court said an efficient system does not require equality of access to revenue at all levels as long as such revenues are used to supplement an already financially efficient system. If the school finance system provides districts with sufficient funds to meet SB 7's seven public education goals, then school districts can spend as much money as they can raise up to $1.50 per $100 property valuation, the state-imposed cap on taxes.

The court rejected property-poor districts' arguments that SB 7's school finance system was inefficient because richer districts — due to their higher property wealth — were permitted to raise up to $600 more per penny of tax effort than property-poor districts. The court said the state's duty to provide districts with substantially equal access to revenue applies only to the provision of funding necessary for a general diffusion of knowledge. As long as property-poor districts could provide for a general diffusion of knowledge under SB 7's school finance plan, SB 7 was constitutional.

District wealth disparity and the $1.50 cap

The Education Code imposes various limits on a local district's tax rate:

♦ $1.50 is the maximum rate for maintenance and debt *combined*, unless voters approve a higher total rate to pay for new debt service or for debt service existing prior to September 1992;

♦ $0.50 per $100 is the top rate allowed for new debt service;

♦ Even with voter approval a district's total rate may not exceed $2.00 ($1.50 for maintenance and operations and $0.50 for debt) except to pay for debt service existing prior to September 1992.

The $1.50 tax rate cap figured in attacks on SB 7 from both property-rich and property-poor districts. The court rejected property-poor districts' arguments that allowing property-rich districts to tax at effective rates above the state-imposed tax rate cap of $1.50 created a "Tier 3" of unequal enrichment, thereby further increasing the disparity of wealth among districts.

The Supreme Court pointed out that "special laws" permit school districts to tax above the state-imposed $1.50 tax rate cap if they need additional taxes to pay off their bonded indebtedness. That the state permits property-rich school districts to tax above the $1.50 tax cap does not make school finance system constitutionally inefficient, the court said, because, "once all districts are provided with sufficient revenue to satisfy the requirement of a general diffusion of knowledge, allowing districts to tax at a rate in excess of $1.50 creates no constitutional issue. Districts that choose to tax themselves at a higher rate under these special laws are, under this record, simply supplementing an already efficient system."

Property-rich districts had argued that the state's $1.50 cap constitutes a statewide ad valorem tax, which is prohibited by Art. 8, sec. 1-e, of the Texas Constitution. The court said a local property tax becomes a statewide tax when the state's control over the tax leaves no discretion to local authorities as to how the tax is imposed.

But the court found that since school districts have a range in which they can set their tax rates, the $1.50 tax rate cap does not amount to a statewide tax. However, if all districts' tax rates approach the cap, the court said, it could find the cap unconstitutional because the districts would lose "all meaningful discretion in setting their tax rates."

Adequacy of state funding

Property-rich districts argued that the state's heavy reliance on local funds represents an abdication of the state's responsibility to provide for education and that SB 7 violated a variety of constitutional provisions. The court found, however, that the Legislature had not violated its constitutional duty to make suitable provision for the public school system. The Legislature, the court recognized, has the right to determine what suitable provision for schools should be. Furthermore, the court found that SB 7's allocation of state aid to schools did not reflect an abdication of the state's responsibility.

However, the court warned that, "if the Legislature substantially defaulted on its responsibility such that Texas school children were denied access to that education needed to participate fully in the social, economic, and educational opportunities available in Texas, the 'suitable provision' clause in the Texas Constitution would be violated."

State recapture

The Legislature is not allowed to compel school districts to pay for the education of nonresident students, the Supreme Court had held in *Love v. City of Dallas*, 40 S.W.2d 20 (Tex. 1931). Property-rich districts argued that SB 7 compelled them to pay for the education of non-resident students to equalize their property wealth. The court, however, found that since SB 7 gave districts options other than paying for education of nonresident students — including consolidation with other districts and detachment of territory — property-rich districts were not compelled to pay for the education of nonresident students, and therefore SB 7 did not violate *Love.*

The court also rejected the property-rich districts' arguments involving the lending of credit or grant of public money, the delegation of power to the education commissioner, judicial review and due process, impairment of contracts, noncontiguity of school districts, the situs tax rule, the Voting Rights Act and Equal Protection Clause, and whether SB 7 is a local or special law.

School vouchers

The court rejected arguments that students have a constitutional right to receive school vouchers from the state. The court said that under the Texas Constitution the Legislature alone decides the structure of the state's public school system and that it was up to the Legislature to decide on the adoption of school vouchers.

CEDs

The court rejected arguments challenging the Texas education commissioner's distribution of funds from county education districts (CEDs) set up by SB 351, the former school finance law.

State funding of facilities

The district court had found SB 7 constitutional except for failure to provide efficient funding for facilities. If the Legislature failed to provide efficient facilities funding by September 1, 1995, the district court said, the court would prohibit the issuance of bonds by school districts. The Supreme Court vacated the district court's injunction, citing evidence that SB 7 ensured that districts could meet both their operations and facilities needs for a general diffusion of knowledge.

The Supreme Court said the state school finance system could be challenged if school operations and facilities were not adequately funded. The court said that "if the cost of providing a general diffusion of knowledge rises to the point that a district cannot meet its operations and facilities needs within the equalized funding program, the State will, at that time, have abdicated its constitutional duty to provide an efficient school system. From the evidence, it appears that this point is near."

FACILITIES PROPOSALS

School facilities are funded largely by local districts, although the state has contended that the vast majority of funds raised for construction are eligible for equalization under the guaranteed yield program.

State funding for facilities would be provided under both House and Senate versions of HB 1, the general appropriations bill for fiscal 1996-97. The House version includes $170 million to build new or renovate existing classrooms; the Senate version, $270 million. Proposals to distribute the facilities funding are included in the House-committee and Senate-passed versions of SB 1 by Ratliff, the omnibus education bill.

House proposal

The House committee substitute for SB 1 would create a school facilities down payment program within the Foundation School Program. The House committee's program, if fully funded, would cost $346 million for the 1996-97 biennium and would help about 535 low- and medium-wealth districts to finance buildings and renovations.

To be eligible for the program, a district would have to have a taxable wealth level per student below the state's guaranteed wealth level, which is currently $205,500 per student. An eligible district would have to impose a total tax rate of at least $1.30 or an interest and sinking (I&S) fund rate, for bond debt, of at least $0.20.

Eligible districts would submit facilities proposals to the commissioner, outlining the project, its estimated cost and the district's effective tax rate. The projects would have to be primarily for instructional facilities. If a district's funding proposal was granted, the commissioner would approve warrants to permit a district to meet its contractual obligations.

For districts with over 2,500 students, the maximum project cost eligible for state assistance would be determined by the number of weighted students in average daily attendance (WADA) multiplied by $200. There would be no limitations on the options a district could use to fund the local share of the project cost.

Districts with fewer than 2,500 students could receive a maximum of $500,000 in state assistance. In addition, these less populated districts would be eligible for supplemental state assistance if the supplemental assistance would not reduce the district's local share of a project's cost below the greater of either $100,000 or the amount a district could raise with a $0.20 tax rate.

If all funds appropriated for the program were not expended, the balance would go to the Foundation School Program. However, if the total amount granted in the program exceeded the total program appropriation, then districts that would receive the least state assistance, as a percentage of the total project cost, would be dropped from the program sequentially, until the amount to be granted under the program was equal to or less than the amount appropriated.

Taxes raised to cover the cost of local share would not be eligible for Tier 2 equalization for the duration of the debt service or lease-purchase agreement, to avoid "double dipping." Districts would be able to recover any difference between what they *would have* received under Tier 2 equalization and what they did receive under the down payment program if the Tier 2 equalized wealth level were raised.

The House's facilities plan further provides that the amount distributed by the program would be a sum certain as appropriated by the Legislature in its biennial budget. It also provides that taxes raised for the local share of projects funded under this program would not be subject to the $1.50 cap.

Senate proposals

The Senate version of SB 1, approved by the Senate on March 27, 1995, would help districts repay bonds for construction of facilities and other capital needs. The Senate plan would make $286 million available to leverage funds for local facilities, with $100 million of that amount earmarked to service existing debt. Through a guaranteed yield the program would allow districts to reduce the tax rate used to finance their I&S fund to pay bond debts.

In the Senate version, SB 1 proposes two guaranteed yield programs separate from Tiers 1 and 2 of the Foundation School Program. To be eligible to receive financing for new facilities, districts would have to have property wealth under $280,000 per unweighted student. For each penny of debt service tax effort these districts raise, up to $0.25, the program would guarantee a yield of $28 per penny per unweighted student.

State funding of facilities would be based on a "compressed tax rate," defined as the I&S tax rate required to make debt service payments based on the total yield per penny from state and local revenues. The increased yield per penny would "compress" the number of pennies of tax rate needed to service a particular amount of debt.

To receive financing aid for existing debt, a district's debt service would have to be funded by taxes levied before the 1995-1996 school year and be above $0.25 of tax effort. For each penny of debt service tax effort these districts raise above $0.25, the program would guarantee at least the state average property wealth per student, currently $18.80. Districts with high historical growth rates would be eligible for additional state aid.

A district could impose a tax rate greater than $1.50 per $100 valuation if that rate was authorized at an election. SB 1 would also allow districts to issue bonds to cover debt in excess of 10 percent of their total property value if the debt issued remained at 10 percent of the district's local share of debt costs.

The determination of need for renovation or construction of school facilities would be made at the local level by the school district and voters. The state would not provide reimbursement retroactively or in the future to districts that finance their facilities with cash.

Although the Senate plan would not consider student "weights" in allocating state funds, the bill would establish a commission to recommend to the Legislature changes to facilities financing formulas that take into account special needs.

If the state failed to appropriate sufficient funds to implement SB 1's facilities plan, Foundation School Program funds would be used to make up the difference.

SJR 53 by Lucio would place on the November 7, 1995, ballot a $1-billion bond proposal to fund grants for public school facilities. The grants, which would be distributed under the provisions of SB 1424 by Lucio, would be used to acquire, construct, repair or renovate facilities and pay existing debt. Eligible districts would have to demonstrate a critical need for school facilities, as determined by inventory conducted by the State Board of Education (SBOE) or have a total tax rate exceeding $1.50 per $100 valuation of taxable property. The SBOE would prescribe the maximum amount of a grant, a method of ranking eligible school districts with a low value of taxable property for grants and the manner in which a district may apply for a grant.

OTHER ISSUES

Proposals on the $1.50 tax cap

Although the Supreme Court rejected property-rich district's arguments that the state imposed local tax rate cap is an unconstitutional statewide ad valorem tax, the court said it would find the cap unconstitutional as more districts approached the cap, because upon reaching the cap districts would lose "all meaningful discretion in setting their tax rates." The court observed that eventually some districts may be forced to tax at the $1.50 rate just to provide a general diffusion of knowledge.

The $1.50 tax rate cap applies to tax rates levied to pay for maintenance and operations (M&O) and to pay for bonded debt (I&S). About 50 districts have nominal tax rates at or above the $1.50 cap and another 172 districts have tax rates above $1.40, out of the state's 1,046 districts.

The Senate version of SB 1 would remove debt service taxes from the $1.50 tax rate cap, allowing many school districts to stay below the 1.50 tax rate cap longer. Increasing state funding of facilities also would allow districts to maintain lower tax rates.

Proposed funding for the school system

The Supreme Court in *Edgewood IV* determined that the minimal acceptable funding for education is $3,500 per student. Since SB 7 makes up to $3,850 per student available in Tier 1 and Tier 2 of the Foundation School Program, SB 7 met the court's school funding standard. However, the court noted that "if the Legislature substantially defaulted on its responsibility such that Texas school children were denied access to that education needed to participate fully in the social, economic, and educational opportunities available in Texas the (state Constitution's) suitable provision clause would be violated."

Both the House and the Senate's version of the 1996-1997 appropriations bills would fully fund SB 7's school finance system therefore apparently satisfying the court's current funding adequacy standard.

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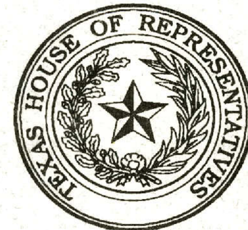

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