MINUTES

School Finance Formula Review Committee

October 5, 2009

MEMBERS PRESENT:

Senator Brian Schoenjahn, Co-chairperson
Senator Nancy Boettger
Senator Robert Dvorsky

Representative Roger Wendt, Co-chairperson
Representative Cecil Dolecheck
Representative Mike May
Representative Sharon Steckman
Representative Cindy Winckler

MEETING IN BRIEF

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I. Procedural Business

Convening and Adjournment. The meeting was convened on Monday, October 5, 2009, at 9:05 a.m. in Room 103, Supreme Court Chamber, at the Statehouse. The meeting recessed for lunch at 11:52 a.m., reconvened at 12:35 p.m., and adjourned at 2:12 p.m.

Election and Approval. Temporary Co-chairpersons Schoenjahn and Wendt were elected permanent Co-chairpersons at the beginning of the meeting, and proposed rules were approved and adopted by the Committee.

Opening Remarks. Co-chairperson Wendt stated that the impetus for conducting the meeting is a statutory requirement that a review of the school finance formula be undertaken every five years. He indicated that such a review involves the receipt and analysis of a large amount of information, and that there is a lot to learn in gaining an understanding of how the formula operates.

II. School Finance Formula Overview

Overview. Mr. Jim Addy, Division of School Information and Support, Department of Education, and Mr. Shawn Snyder, Fiscal Services Division, Legislative Services Agency, provided a comprehensive overview of the basic operation of Iowa's current school finance formula. From an organizational standpoint the overview consisted of an examination of the elements included within combined district cost; and a discussion of various funding sources, including school district revenue derived through the operation of the formula, a variety of levies facilitating local funding discretion, the statewide sales and use tax for school infrastructure, and state and federal categorical funding sources. With regard to the levies, Mr. Addy stated that they are generally intended to fund specified purposes or objectives, and that the Department of Education anticipates proposing legislation during the 2010 Legislative Session which would allow consideration of making one-time exceptions to certain funding source requirements.

District Cost. Mr. Addy listed the various components of combined district cost, and noted that the 2010 Aid and Levy Worksheet, maintained by the Department of Management, is accessible online and provides a district-by-district breakdown of school finance formula operation. He characterized regular program district cost as the basic pool of money for a school district, and discussed the impact of weighted enrollment on the formula's pupil-driven system. The dollar value equivalents for special education and shared program and incentive supplemental weighting for FY 2010 were presented.

Special Education. Committee inquiry and discussion included the process through which a student is classified as falling into one of the three special education weighting categories; what guidelines exist to assist in that classification; how many teachers per student are included within a given classification level; that school districts are required to provide the least restrictive educational environment within the guidelines; and that School Budget Review Committee determination of weighting amounts is confined to special education weighting, with other forms of supplemental weighting specified by statute. Mr. Addy additionally discussed the impact of the budget guarantee and budget adjustment on the regular program budget for districts experiencing minimal or nonexistent enrollment growth.

Area Education Agencies. Mr. Snyder provided a historical perspective about the development and evolution of area education agencies (AEAs) in the state, and discussed the flow-through nature of AEA funding and that AEAs do not possess independent taxing or spending authority. Previous and anticipated AEA mergers were identified, the three forms of AEA program services to local school districts were discussed, and charts and graphs depicting AEA funding by source and expenditures by function were supplied. Additionally, Mr. Snyder discussed the calculation of allowable growth and provided the highest and lowest ranges for district cost per pupil.

Revenue Sources. The focus of the presentation then shifted to sources of school district revenue. The basic "building block" revenue schematic involving the uniform levy, state aid, and the additional levy was presented, as were statewide dollar value totals for each. A financial breakdown of federal categorical aid was also presented, with the point emphasized that the totals are higher than in prior years based upon amounts received pursuant to the American Recovery and Reinvestment Act of 2009 (ARRA). The lack of continued federal stimulus money in future years was characterized as a "funding cliff," and while all school districts have received their allocation of stimulus funding, not every district has expended it. It was noted that other sources of federal funding are received in the form of "Title Programs" and the website for tracking the receipt of such funding by school district was identified. The website is http://www.iowa.gov/educate; A to Z Resources; Allocations. Additionally, dollar value equivalents were supplied for combined district cost, the various levies, and the statewide sales and use tax for school infrastructure. Committee discussion included which levies were board-approved, voter-approved, or a combination of both; and the criteria required for utilization of statewide sales and use tax revenue for school district projects.

Recent Iowa Enactments. The presentation concluded with Mr. Snyder presenting a historical overview of school finance law changes enacted during the preceding four legislative sessions. The changes included the ability of school districts with high property tax rates to qualify for additional property tax adjustment aid, the availability of property tax assessment appeal repayments under specified circumstances, increasing the duration for which English as a Second Language supplementary weighting can be received, increased supplementary weighting for designated sharing incentives, adjusted supplementary weighting for the Home School Assistance Program and community college courses and reauthorized weighting for regional academies, repeal of the local option sales tax for school infrastructure and replacement with a statewide sales and use tax, the inclusion ("roll-in") of certain state programs into categorical allowable growth, and adjustments in the form of across-the-board reductions and the ARRA. Committee discussion included the necessity for statutory authorization in relation to points raised in written testimony received by the Area Education Agencies of Iowa regarding AEAs' inability to recoup budget losses or count preschool students in the enrollment count.

III. Categorical Allowable Growth Overview

Mr. Snyder next provided more in-depth information regarding the categorical allowable growth formula which began during the 2008 Legislative Session. He contrasted funding for the programs subject to the roll-in (educational excellence, early intervention/class size reduction, and student achievement teacher quality) prior to FY 2009-2010, which had been appropriations-based, with funding on a per-pupil basis and subject to an allowable growth calculation beginning in FY 2009-2010. Charts were presented detailing the impact of the programs fund roll-ins and the categorical allowable growth on per-pupil foundation levels and the budget guarantee, the categorical supplement allowable growth rate calculation procedure and amounts, estimated calculations for FY 2011-2012, and variances in cost-per-pupil amounts attributable to FY 2009-2010 funding being based on FY 2008-2009 allocation amounts.

IV. Comparing Iowa's School Finance Formula With Other States

Overview. Mr. John Myers, Augenblick, Palaich, and Associates, Inc., compared and contrasted the operation of Iowa's school finance formula with finance formulas from other states. Mr. Myers provided background information regarding his experience in school finance, indicating that he has visited 48 state legislatures about the subject, with particular emphases on equity, adequacy, student achievement, and teacher quality issues. In placing Iowa's school finance formula within the context of other states, Mr. Myers employed a model formula which Iowa's formula emulates to a certain extent. He stated that there are currently 56 million students in kindergarten through grade 12 education nationally, attending 98,000 public schools across the county. Iowa has fewer than the national average of charter schools, spends less than the national average on teacher salaries, and has more school districts on average with a greater emphasis on local control. He noted that Iowa's supplementary weighting system for school district sharing services has been studied and adapted by other states.

Revenue Mix. Mr. Myers contrasted the mix of state aid and property tax in different states, indicating that the mix varies, as does local school board control, to a considerable extent. There are, however, two primary components to every state school finance approach — spending needs and generating revenues to pay for them — and Mr. Myers stated that problems emerge when these components are mixed together rather than treated separately. Almost every state constitution requires state responsibility for education funding, and in most states that funding begins with some form of base cost reflecting the spending needs of school districts. The base cost figure is then adjusted in recognition of school district size, unique situations, and student needs such as at-risk, special education, and English as a Second Language. Revenues to pay for the spending needs are derived from some combination of federal funding targeted at program-specific activities, state dollars aimed at equalizing local variation, and property taxation.

Iowa Comparison. Mr. Myers next distributed a handout entitled "How Do You Know A 'Good' School Finance System When You See One?" and assessed the extent to which Iowa's formula measures against several factors. Iowa compares favorably regarding the extent to which allocation of state aid reflects differing school district needs, primarily through supplementary weighting and, until phased out, the budget guarantee. Iowa's state aid allocation is satisfactory, but an increase to 100 percent would better recognize each school district's fiscal capacities. In terms of recognition of student needs, Mr. Myers again cited supplementary weighting as a positive, but indicated that Iowa's special education weightings may cumulatively fall below average, and that at-risk funding definitely does. School districts in Iowa have an average amount of flexibility when compared with those in many other states, within the confines of their maximum spending authority, but a larger than average amount of local control which varies from a federally inspired national trend toward centralized standardization and control. With regard to state aid sensitivity to school district wealth or need, the 87.5 percent foundation base is fairly effective, but the variety of optional levies perpetuates a property tax rich versus poor district dynamic. Mr. Myers stated that some states allocate resources directly to school sites, which can result in less district-to-district variation, and that accountability through performance standards can be implemented to justify continued funding, albeit with a sacrifice in local control.

Concerning taxpayer equity, Iowa was described as doing better than most other states in relation to property tax assessment practices, with the major issue being farmland valuation. It was observed that nationally the trend is to increase property taxes and decrease sales and income taxes for school district funding purposes. It was additionally stated that our statutorily mandated five-year formula review assists the state in monitoring the school finance formula, but that some other states conduct more frequent, or ongoing, reviews to define and measure equity and adequacy.

Committee discussion included national trends regarding the number of home-schooled students, distribution methods for at-risk funding and assessing how much funding is needed, the extent to which funding received by sites within school districts is public information, commercial property tax rates versus rollbacks available for agricultural and residential property, and Iowa's unusual status in avoiding litigation regarding equity and adequacy issues.

Other Issues. Finally, Mr. Myers discussed issues and projections relevant to school finance funding during the next five years. He echoed the characterization in an earlier presentation that the ARRA stimulus funding can be viewed as a funding "cliff," indicating that this fiscal year has constituted the lowest overall increase in kindergarten through grade 12 school district spending ever recorded, that the federal funding has in large measure been used to "backfill" school district budgets, and that some states have been reluctant to expend the funds for programs which will not be supportable in future years. Mr. Myers reiterated that Iowa should devote more attention to weighted funding directed to high-needs students and schools. He also addressed teacher compensation, emphasizing that teacher quality standards need improvement and that involving teachers as partners in the decision-making process yields positive results. Mr. Myers was critical of the state's abandonment of incentives for teacher performance and cited research supporting a direct link between money spent on teacher salaries and incentives and resulting student performance.

Committee discussion included recognition of the growth in student achievement scores rather than strict reliance on standardized measures, the lack of attention paid on the state and federal level to "people in the trenches," the inequities resulting from the large number of levies and large number of school districts approving or adopting them, the need to tie funding to student performance, the fact that the state's basic school funding structure is sound but its implementation could be improved, and the variation between states in the amount of funding earmarked for professional development.

V. Property Tax Issues

Overview. Mr. Snyder conducted a comprehensive review of the integration of property taxes into the school finance formula, and the issues and inequities which are inherent in a state aid and property tax mix. He began by providing a historical perspective dating back to the 1960s, noting that local property taxation was the basic funding mechanism through the 1960s, that state aid was introduced during the 1970s, that Iowa's current school finance formula was enacted in 1989 and applicable to the school budget year beginning in 1992, that property tax relief in the form of increased foundation percentages for the regular program and special education has occurred, and that the state sales and use tax for school infrastructure provides an additional funding element. Mr. Snyder presented a series of charts and graphs depicting state aid and property tax levels and proportions since 1992, observing that during this period state aid increased both as a percentage and a dollar amount in comparison to property taxes, and that property taxes attributable to the school finance formula have declined slightly as a percentage of all forms of property taxation.

Additional Levies. Mr. Snyder then discussed in more detail than during his morning presentation the various levies available to school districts as funding mechanisms. Major points included the fact that the additional levy has a funding cap but is not rate restricted, that the instructional support program levy state aid cap creates a funding shortfall, that the management levy is use restricted but not rate restricted, that the public education and recreational levy is utilized by only 18 school districts, that the stability of the debt service levy may be attributable to the previous existence of the local option sales tax for school infrastructure, and that through the cash reserve levy school districts can recoup across-the-board funding cuts. Mr. Snyder also addressed the impact of property valuation variations between school districts upon the operation of the school finance formula and the amount of state aid received, illustrating this through a series of "property rich" versus "property poor" school district examples. Additionally, the relationship between per-pupil valuations and property tax rates was discussed, with the general observation that school districts with higher per-pupil valuations will generate more tax revenue at a fixed rate, will have a lower property tax rate for levies with no rate caps, and will receive less state aid through operation of the formula. The opposite would hold true for school districts with lower per-pupil valuations. It was noted that the impact of the instructional support levy state aid cap results in districts with lower per-pupil valuations receiving proportionately less funding.

Policy Issues. Further, Mr. Snyder listed the various components of the additional levy, summarized the operation of the Secure an Advanced Vision for Education and the Property Tax Equity and Relief components of the statewide sales and use tax for school infrastructure, and discussed the impact of tax increment financing (TIF) on school district property taxes. Mr. Snyder stated that levy rates increase as a result of the failure to include the TIF increment when calculating district property tax rates (other than the debt levy and physical plant and equipment levy), and that state aid required to backfill the uniform levy due to TIF totaled $45.1 million for FY 2010. Finally, Mr. Snyder presented potential funding alternatives which could generate property tax relief, with the caveat that they were for illustrative purposes only and not to be considered recommendations by the Legislative Services Agency. The alternatives included expansion of the income surtax, with the cautionary comment that fluctuating income tax revenues levels are observable particularly in recessionary periods; increasing the state foundation level; and changes in TIF diversion relative to levy rates.

VI. School District Budget Issues

Fund Balances. Ms. Lisa Oakley, Department of Management, and Ms. Su McCurdy, Department of Education, discussed aspects of the school district budgeting process including ending balances, deficit spending, cash reserves, and the role of the School Budget Review Committee (SBRC). The definition and calculation of a school district's unspent authorized budget or unspent balance was reviewed, with the comment that the Department of Management's website can be used to access a listing of each school district's unspent balance. The unspent balance constitutes a school district's spending authority, in contrast to the district's ending fund balance or unexpended balance, which reflects the school district's ability to finance its spending authority. It was noted that if the unexpended balance is negative, the result is a financial condition comment in an audit, but that deficit spending is not disallowed by statute. Ms. Oakley presented a graph depicting general fund ending balances as a percentage of expenditures, with the average school district maintaining an unexpended balance of 11 percent of its authorized expenditures. With regard to negative fund balances, it was observed that school districts vary considerably regarding their comfort level in operating with a negative balance, with some districts placing a higher priority for lowering property taxes than for sound financial management. Negative balances can also be attributable to unanticipated expenditures occurring late in a school year, confusion on the part of a school district regarding unspent versus unexpended balances, certified and line item budgets exceeding the authorized budget, and accounting errors.

School Budget Review Committee. The role of the SBRC as a budgetary safety valve designed to counterbalance authorized budget limits and provide a measure of flexibility was discussed. The authority of the SBRC is limited to "unusual or unique" circumstances, and its assistance takes the form of modified allowable growth. It was noted that the SBRC serves in an advisory capacity with regard to school district negative fund balances, that such balances tend to track the economic condition of the state in general, and that school districts are required to submit corrective action plans for review by the Department of Education.

Additionally, the rationale for levying for cash reserve, either to facilitate cash flow or to replenish such reserves to a specified level, was addressed. The SBRC's role with respect to cash reserve levies is to evaluate from a financial management perspective whether a levy can be considered excessive. Current and future statutory limits regarding cash reserve levy limits were highlighted, as was the impact of an across-the-board cut on school districts. It was pointed out that such cuts reduce cash, but do not reduce a school district's spending authority, and that school districts will generally either expend cash on hand and levy for cash reserve to replenish it, or borrow in the event sufficient cash is not available and levy for cash reserve to repay borrowed funds.

Committee discussion included the number of school districts faced with the prospect of borrowing funds to cover costs, the number of school districts with larger-than-average unspent balances, the appointment process for membership on the SBRC, and the extent to which the Department of Education tracks the amount of cash maintained in reserve by school districts.

VII. Conclusion

Prior to discussing the recommendations process, Co-chairperson Schoenjahn distributed a letter soliciting the submission of ideas for making state government more efficient and effective, and providing e-mail addresses for members, and their constituents, to utilize for this purpose. Co-chairperson Schoenjahn explained that the letter was originally distributed to members of the Joint Appropriations Subcommittee on Education, for forwarding to the State Government Reorganization Commission, and that he would welcome the input of School Finance Formula Review Committee members.

With regard to recommendations, the Co-chairpersons stated a preference for taking some time to evaluate the information presented during the meeting prior to formulating specific recommendations, and encouraged committee members to offer input via e-mail after the conclusion of the meeting. Preliminary comments from committee members included the following:

- Conducting an in-depth study regarding the effectiveness of the school finance formula.
- Examining the sufficiency of all forms of supplementary weighting, including sharing incentives, at-risk, and special education.
- Conducting the review meetings more frequently than the statutorily mandated five-year interval.
- Recognizing that until the state's economic condition improves, Iowa may not be in a position to make any significant changes or improvements, and that there appear to be indications that from an equity standpoint some progress has been made.
- Exercising caution in formulating recommendations without sufficient information underlying them.
- Evaluating the merit of continuing to provide supplementary weighting for a three-year period during which school districts merely consider the possibility of consolidating or merging.
- Taking every opportunity for collaboration and maximizing utilization of existing resources.
- Mitigating the likelihood of increasing reliance on property taxes given the state funding shortfall, and including property taxation in any future studies relating to the school finance formula.

VIII. Materials Filed With the Legislative Services Agency

The following materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the "Additional Information" link on the Committee's Internet webpage:
http://www.legis.state.ia.us/aspx/Committees/Committee.aspx?id=489

1. Follow-Up to Questions From the School Finance Formula Review Committee Meeting; Legislative Services Agency.

2. A Summary of Research and Resources Related to State School Funding Formulas; Midwest Regional Education Laboratory.

3. Comparing Iowa's School Finance Formula to Other States; Augenblick, Palaich and Associates, Inc.

4. FY 2010 School Aid Weightings; Legislative Services Agency.

5. How Do You Know a "Good" School Finance System When You See One?; Augenblick, Palaich and Associates, Inc.
6. Income Surtax Alternative Example — FY 2010 Income Surtax Information By School District; Legislative Services Agency.
7. Increasing the Uniform Levy Rate and Foundation Level Percentage; Legislative Services Agency.
8. Instructional Support Program Funding; Legislative Services Agency.
9. Legal Background Briefing on Education Finance — Categorical Allowable Growth; Legislative Services Agency.
10. Legal Background Briefing on Education Finance — Regular Program Allowable Growth; Legislative Services Agency.
11. Legislative Guide — Basic Iowa Education Finance; Legislative Services Agency.
12. Letter from Iowa State Education Association President.
13. Letter from State Government Reorganization Interim Committee.
14. Memo and Attachments Regarding School Property Taxes by School District for FY 2010; Legislative Services Agency.
15. School District Budget Issues; Ms. Oakley, Department of Management, and Ms. McCurdy, Department of Education.
16. School Finance Formula Review Interim Committee — School District Property Taxes; Legislative Services Agency.
17. School Finance Formula Review Interim Committee — State Categorical Supplement School Aid Funding; Legislative Services Agency.
18. School Finance Overview in Iowa; Mr. Addy, Department of Education, and Mr. Snyder, Legislative Services Agency.
19. School Finance Overview in Iowa — Addendum; Mr. Addy, Department of Education, and Mr. Snyder, Legislative Services Agency.
20. Written Testimony from the Iowa Association of School Boards.
21. Written Testimony from the Sioux City Community School District.

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