



Final Report of
School Finance Task Force
to the
Colorado General Assembly
School Finance Interim
Committee



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EXECUTIVE SUMMARY

Today's rigorous demands of state education systems require school finance structures that reflect an adequate level of state education spending for each school district, the schools within those districts and the needs of each student within the schools.

The Task Force believes that the existing school finance system needs to fundamentally change so that funding is based on a combination of adequate resources to meet local, state and national performance goals and is distributed equitably among all Colorado school districts. As we move from an expectation of universal access towards meeting an expectation of universal proficiency, one that leaves no child behind, we are also moving toward more clearly identifying the programs and resources needed to support this goal. The move from fiscal equity to adequacy in school finance is a momentous shift.

The Task Force believes a foundation expenditure level must be "adequate¹," i.e. sufficient to enable every student to reach proficiency in the local, state and federal performance standards. An "adequate" foundation of spending should be established through a higher amount of statewide base per pupil spending that reflects the academic accountability requirements of public schools. The level of base per pupil spending has been inadequate in prior school finance acts because it has never been set based on the academic performance expectations. Success in setting an "adequate" foundation expenditure level and developing an "adequate" school finance system can only happen if a reliable and predictable state tax policy structure capable of generating adequate resources is formed.

The Task Force has two recommendations for the Interim Committee:

- I. The Task Force recommends the General Assembly should:
 - a. revise the 1994 School Finance Act;
 - b. significantly increase education spending; and
 - c. examine the adjustments to base per pupil funding.

- II. The Task Force recommends state funding and laws for capital should ensure that all Colorado students attend school in safe and effective learning environments. This funding should be included within the state's school finance funding, but would be in addition to per pupil total program funding.

As an additional consideration, the Task Force believes Colorado should establish a P-16+ Council which is charged exploring issues related to an integrated education system from preschool through higher education.

Realizing that most of these recommendations cannot be accomplished without additional revenue, the Task Force created a list of potential funding sources. The list includes issues that could be addressed by the General Assembly and others that require a vote of the people. The Task Force has not attempted to develop a consensus on which of these sources should be pursued, nor is the group advocating for any particular funding source.

This report provides a philosophical context for the school finance discussion, with tools to consider as the Interim Committee debates what's possible. The Task Force stands ready to further assist with this important public policy debate that is so critical to the quality of Colorado's public education system.

¹ The Task Force uses the word "adequate" to mean the amount of funding necessary to provide the programs and services needed for a student to meet the academic expectations of accreditation, school accountability reports and the federal No Child Left Behind Act. This is not to say that school districts should not be permitted to generate revenue above an adequate level in order to meet their unique needs, some of which cannot be quantified by the state. The Task Force is aware that the word "adequate" is being used in school finance discussions across the country and that the term is defined differently in other states. The Task Force does not want the use of this term, which is the subject of debate in other contexts, to detract from the Task Force's work.

INTRODUCTION

Today's rigorous demands of state education systems require school finance structures that reflect an adequate level of state education spending for each school district, the schools within those districts and the needs of each student within the schools.

Colorado has been a leader among the states in designing school finance systems that promote student and taxpayer equity while also permitting a significant level of local control. Thirty years ago, the system was designed so that districts that chose to make higher tax effort could spend more while simultaneously assuring that higher amounts of state aid went to districts with relatively lower wealth.

In 1988, the state moved to a "foundation" approach, designed to assure a minimum spending level in every district but assuming that the uncontrollable costs districts faced could be accounted for by organizing all districts into eight groups in which the needs of districts within each group were thought to be similar while the needs across groups were viewed as being different.

In 1994, a new school finance act was developed that recognized the costs associated with school district size, cost-of-living differences across districts, and the cost pressures associated with serving students coming from low income families. That system also provided "categorical" funding that was not sensitive to district wealth

differences to support the costs of special education and students with English language problems. Too, the system limited the extent to which districts could generate funds on their own. At the time, that system was designed to achieve a high level of equity for students and taxpayers.

Neither the 1988 nor 1994 Acts established a base level of per pupil funding prior to addressing other school finance adjustments that were meant to achieve funding equity. Base per pupil funding was set at a dollar figure that represented the amount of money not already dedicated for other purposes. In effect, base per pupil funding became an afterthought in prior Acts.

Since 1994 many changes have taken place in our state, both from legislative action and from ballot initiatives, that affect school districts' ability to generate local property tax revenue, set a minimum level by which state aid must rise from year to year, and hold school districts accountable for the performance of their students. Over the last 10 years, the ability of the system to promote inter-district fiscal equity or to assure that adequate funds would be available in all school districts has deteriorated. A revised school finance system is needed that builds on the strengths of the existing one while addressing the myriad of issues that have arisen in the last 10 years.

The Task Force believes that it is essential to develop a strong state aid formula, one that recognizes as many of the uncontrollable cost pressures districts face as is possible to measure and is sensitive to the wide variations in wealth and property value per student that exists among the state's 178 districts.

The Task Force agreed on a set of attributes that should be used to evaluate the state's school finance system. Those attributes answer the following questions:

- a. Is the system equitable?
- b. Is the system adequate?
- c. Is the system accountable?
- d. Is the system adaptable?
- e. Is the system understandable?
- f. Is the system supportive of local community values?

In addition, the Task Force believes that a set of principles should guide the revision of Colorado's school finance system. The Task Force reached general consensus on a set of principles, which are shown on the following page. It should be noted that not every Task Force member agreed with every principle, but no one objected to forwarding the list of principles to the Interim Committee for discussion.

GUIDING PRINCIPLES FOR REVISION OF A SCHOOL FUNDING FORMULA

Resource Allocation

1. Funding should be adequate and reliable, structured to equitably meet the educational needs of those students served by public education in Colorado.
2. The majority of funding, including state grants, should be distributed to school districts through a formula that considers the needs and fiscal capacities of individual school districts.
3. The funding system must support student achievement and be flexible enough to deal with economic fluctuations (boom/bust) and changes in educational expectations.
4. The funding system should be built on a per-student base cost that reflects the revenue needed for a regular student (a student without any special needs) to meet the state-mandated model content standards and other legislated accountability requirements.
5. Adjustments to the per-student base cost should equitably reflect added costs of delivery of services associated with the school district or the student that require supplementary expenditures.
6. Adjustments to the per-student base cost should be based on verifiable indicators which impose costs that are beyond a district's control.
7. There should be a regularly scheduled review of the economic factors on which funding is based.
8. The state should identify and implement a consistent definition for determining the actual number of "at-risk" students for funding purposes.
9. State funding for capital should be based on needs of districts and their relative fiscal capacity to pay, as well as evidence of reasonable local effort.
10. Funding for transportation should be provided that takes into consideration the unique circumstances districts face in transporting students.
11. Adjustments to total program funding should be made to reflect the impact of public school choice.
12. The state funding system should be based on a reasonable and consistent state and local effort.

Accountability

13. School districts should make it a priority to continue to develop procedures for allocating resources to schools that reflect the needs at those sites.
14. The state should hold districts accountable for student performance and appropriate legal requirements.
15. School districts should be accountable to taxpayers.

Local Control

16. The state should not specify how district funds are allocated.
17. Any funding formula should preserve local control when allocating resources. The locally elected school board should allocate resources to align with its district programs for educational delivery.
18. There should be flexibility, based on local factors, in implementing mandated programs.
19. To reflect the differing needs of their students and communities, school districts should be permitted, with limitation and voter approval, to utilize additional local revenue in excess of the adjusted base amount determined in the formula.

SCHOOL FINANCE ACT HISTORY

The Public School Finance Act of 1988 (1988 Act) was developed and adopted to establish a financial base of support that was adequate for the delivery of educational services. The factors and characteristics utilized were evolutionary steps in the General Assembly's effort to achieve equity in school funding. To understand the 1988 Act, it is necessary to study the development of equity to both the taxpayer and the student, and to review the components of efficiency that would improve financial equity among school districts. For purposes of funding, the state adopted eight "setting categories" and placed each school district into one of these categories.

The 1988 Act:

addressed taxpayer equity by:

- moving toward a uniform property tax levy.
- limiting the growth of and reliance on property tax for the support of public education.

addressed student equity by:

- requiring the State Board of Education to adopt high measurable goals for student achievement, attendance and graduation of Colorado students.
- providing financing for instructional supplies and materials for public education.

addressed district equity by:

- providing state assistance for the financing of projects through the capital reserve fund and insurance.

- creating a mechanism to better recognize the effects of enrollment trends on the funding of public education.
- providing each district in a setting category with the same amount of per-pupil funding.

Shortly after passage of the 1988 Act, districts began to challenge the lack of equity that grew out of the setting categories. Placing each of 176 school districts into one of eight funding categories opened the door to challenges based on the dissimilarities between districts. In the early 1990's, threatened litigation was based on the differences in equity between similarly classified districts. A Legislative Council Staff study concluded that the use of discrete categories of districts for school funding purposes was not warranted.

1994 School Finance Act

Pressure arising from these equity issues led the Colorado General Assembly to adopt the Public School Finance Act of 1994, (1994 Act) substantially revising the formula for distributing state money to school districts. The legislative intent was the same for both the 1988 and 1994 Acts. However, in 1994, the statute was amended to declare that the new act was a furtherance of the General Assembly's duty under Section 2 of Article IX of the state's constitution to provide a thorough and uniform system of public schools throughout the state that would operate under the same finance formula. In addition, equity considerations dictated that all districts be subject to the same expenditure and mill levy maximums defined by state statute.

Under the 1994 Act, funding for each district is determined through a formula reflecting per-pupil funding amounts, distributed based upon the number of pupils and adjusted for at-risk students, district size, each district's cost of living, and a personnel cost factor. At-risk student needs are measured by the number of students qualifying for the federal free lunch program.

Other nuances of the 1994 Act designed to ensure equity were:

- a limit on property tax mill levies in an amount equal to the lesser of the prior year's mill levy or the levy allowed by TABOR.
- state categorical support funds were established as part of the Act but outside the formula to include special education, English language proficiency, gifted and talented, vocational education and transportation.

School district funding has not kept pace

Prior to the 1994 Act, school districts faced several years of unanticipated mid-year revenue cuts that caused a loss of revenue for K-12 public education on a per pupil basis. The change of the school district fiscal year to coincide with the state's fiscal year was done primarily to balance the state's budget by reducing the state's fiscal obligation for funding the 1988 Act. This shift by the state significantly reduced local school district cash resources. At the time of implementation of the 1994 Act, school districts had collected and analyzed data to create a concrete and verifiable image of what six years of losses cost the students of Colorado.

Part of the work of the Colorado School Finance Project (CSFP) is to quantify the impacts of the changing financial situation and reflect it in terms of district and state losses. In the eighth in a series of annual school district profiles¹ issued by the CSFP in 2002, based on data from the Colorado Department of Education, there was a range of loss per student from \$400 to \$800 per year. This became known as the "gap," which assumes that dollars spent in the 1988 Act were adequate if accompanied by an adjustment for district growth and inflation.

In the late 1990's this gap in funding resulted in a ballot initiative known as Amendment 23, which was approved by the voters in 2000. The initiative was designed to bring districts up over ten years to the 1988 spending levels. This was a "catch up" measure to be accomplished by providing an additional 1% after growth in the student population and inflation. This formula should not be construed as adequate and equitable funding, because that was not the intent of Amendment 23. The intent of Amendment 23 was to help stabilize funding for school districts and ensure an increase in funding that would mirror growth plus inflation.

Amendment 23 was *not* intended to be reflective of the demands of a standards-based approach to education or to provide sufficient funding to meet the increased academic expectations found in new legislative programs (see diagram on page 11). While some may believe that Amendment 23 was burdensome to the state during the recent economic downturn, it in effect created a "rainy day" fund that helped the state avoid making deep cuts in public school funding during the recession.

Withholding a portion of per-pupil funding intended for distribution to school districts has become a standard practice since Amendment 23 was implemented. The state is required to increase base per-pupil funding by at least inflation plus 1% and has done so. However, funding for the School Finance Unit of the Department of Education was previously provided by the state's general fund. Now it is funded with monies withheld from school districts.

How does Colorado compare today?

Numerous studies and statistical reports have demonstrated to the Interim Committee and Task Force a funding system for K-12 education that has failed to keep pace with demand. The "gap" in funding on a per pupil basis was discussed above. In addition, categorical programs have

been significantly underfunded. Legislative Council staff presented a report to the Interim Committee that showed a total of \$646 million in unreimbursed expenditures for categorical programs.² These unreimbursed expenses for high cost, but necessary programs, negatively impact school budgets, which in turn affect the ability of school districts to provide a quality education program for every child.

So, how does Colorado compare to other states? From a variety of sources we learn that Colorado ranks very low in funding schools on a per pupil basis, has a relatively low state and local tax burden, at the same time its citizens are relatively wealthy in comparison to other states.³ The Task Force believes the state can do better for its children.

WHERE DOES COLORADO RANK IN COMPARISON TO OTHER STATES?

1. Colorado ranks 50th in the nation in state and local taxes. (U.S. Department of Commerce, Bureau of Economic Analysis, April 2004)
2. Based on revenue per pupil, Colorado ranked 29th in FY 2002-03, the most recent year for which census data is available. Meanwhile, Colorado fell to 49th in revenue when measured per \$1,000 of personal income. (Harwood, "School District Mill Levies," Memorandum to Interim Committee on School Finance, August 2, 2005)
3. Colorado was 49th in federal revenue received per pupil, 39th in state revenue per pupil and 17th in local revenue per pupil in FY 2002-03. These rankings follow a similar trend when revenue is measured per \$1,000 of personal income, with rankings of 48th in federal revenue, 41st in state revenue and 23rd in local revenue. (Harwood memorandum)
4. Colorado is one of the 10 richest states in per capita income, 2nd in the country for the percent of people with college degrees and in the bottom 10 for school spending. (Quality Counts, Education Week 2005)
5. The US Department of Commerce's Bureau of Economics Analysis 2002 calculates each state's total taxable resources dedicated to education. The national average is 3.8%, Colorado is 3.2% and ranks 45th in the country.
6. Colorado's average elementary class size is 23.3, one of the highest in the nation. The national average is 21.2 (Quality Counts, Education Week 2005)

COLORADO SCHOOL FINANCE 2005

The Task Force believes that the existing School Finance Act needs to fundamentally change so that the funding is based on a combination of adequate resources to meet local, state and national performance goals, and is distributed equitably among all Colorado school districts. Experts agree that some form of standards-based education will remain the focal point of educational policy for many more years. As noted before, the 1994 Act was created in large part to address the distribution of resources equitably across the state. It did not contemplate the effects of constitutional amendments such as TABOR and Gallagher in creating a wide range of mill levies, nor did it anticipate the federal No Child Left Behind Act (NCLB) and state education reforms.

What has changed?

As we move towards meeting an expectation of universal proficiency, one that leaves no child behind, we are also identifying the programs and resources that different districts need to serve the diverse populations they serve. The move from fiscal equity to adequacy in school finance is a momentous shift. The new level of federal involvement in education is unprecedented. Implementation of NCLB, through Colorado's state plan, has a financial impact on school districts that exceeds the level of federal funding provided.

Over 30 states have completed an analysis to determine adequate spending levels. The Colorado School Finance Project (CSFP)

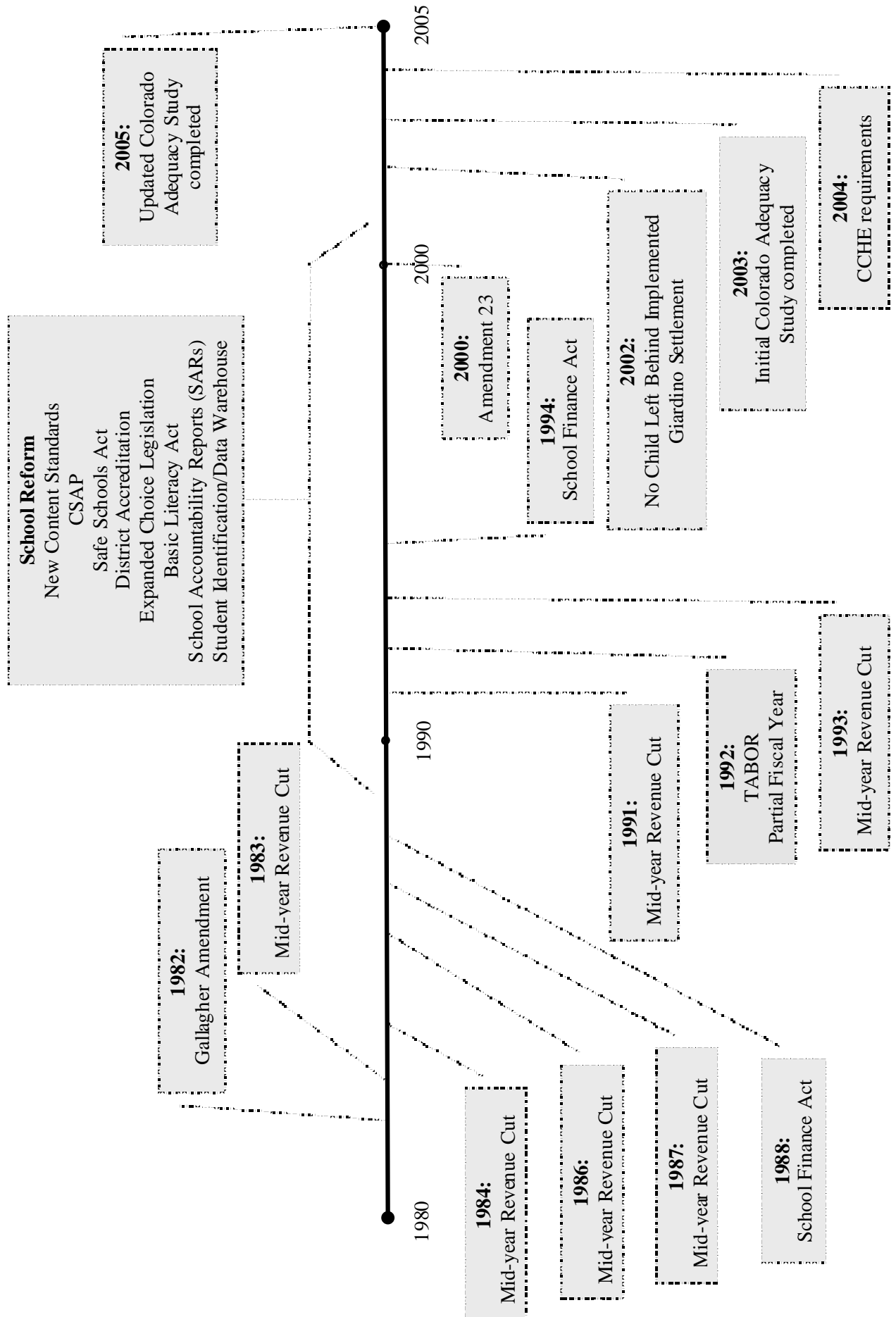
commissioned an Adequacy Study for Colorado in 2002⁴ (updated in 2004). The study was performed by Augenblick Palaich and Associates (APA).

As presented to the Task Force and the Interim Committee, the Adequacy Study:

- objectively demonstrated that issues of both adequacy and equity must be considered in funding a thorough and uniform system of public education in Colorado.
- quantified the financial concerns of school districts around the state through a credible and defensible analysis.
- articulated financial needs tied to academic achievement, helping communities be proactive regarding state policies.
- considered how a new school finance system might address the variety of pressures districts face under the current system.
- specifically addressed issues around special education, English language learners and at-risk populations.

The Task Force believes a foundation expenditure level must be "adequate," i.e. sufficient to provide the programs and services needed for a student to meet the academic expectations of accreditation, school accountability reports and NCLB. Success in this area can only happen if an adequate school finance system is coupled with a reliable and predictable state tax policy structure capable of generating adequate resources.

A GENERATION OF COLORADO SCHOOL FINANCE AND EDUCATIONAL REFORM



RECOMMENDATIONS

- I. **The Task Force recommends the General Assembly should:**
 - a. **revise the 1994 School Finance Act;**
 - b. **significantly increase education spending; and**
 - c. **examine the adjustments to base per pupil funding.**

The Task Force supports a base that is defined as “the amount needed for a student with no special needs to meet the expectations implicit in accreditation, school accountability reports and NCLB.” The Task Force supports increasing the base amount to an adequate expenditure level as opposed to allocating on the less reliable basis of revenues available.

The Task Force believes identifying an adequate level of base per pupil funding should be the first priority in a new state school finance formula. The base funding amount should provide adequate resources to allow school districts to meet academic accountability standards that exist at the local, state and federal levels. Adjustments to the base are necessary, but should not take precedence over properly identifying this dollar amount.

The Task Force discussed several different ways the General Assembly could calculate how much additional revenue is necessary for per pupil funding to be termed “adequate.” There are many assumptions that go into this analysis and different models to use. A good place to start the discussion, though, is to calculate the current gap in funding, compared to a previous point in time and address the \$646 million of unreimbursed expenditures for categorical programs. The CSFP’s adequacy study estimated that funding must increase in the range of \$800 million to \$1.5 billion to be “adequate.”

It is important that any funding formula should preserve local control when resources are allocated. The locally elected school board is in the best position to allocate resources to align with its district programs for educational delivery.

Adjustments to Total Program Funding

The Task Force recommends the following adjustments, many of which have been modeled for the Task Force:

1) Size:

The Task Force recommends a formula that recognizes the cost impact of size on each school district, which may be different than the calculation of the size factor in the current formula.

2) At-risk:

The Task Force recommends the current definition of at-risk be expanded so there is a direct correlation to the kinds of programs needed for a student to meet the academic expectations.

3) English Language Learners:

The Task Force recommends that the state provide funding for English Language Learners as part of total program. This includes increasing the length of time that identified students are funded in order to match the federal definition of three years and tying this adjustment to the size of the district and any student need relative to meeting academic expectations.

4) Special Education:

The Task Force recommends funding for special education be part of total program. The state should use information that establishes a level of resources needed for a special education student to meet the standards and takes into consideration the district's size when distributing aid. The state should look at different models for distribution of special education funding.

The Task Force recommends that the students with the most severe needs have additional dollars outside the formula.

5) Gifted and Talented:

The Task Force recommends that the state assure sufficient funding for gifted and talented students as part of total program. Current statewide identification and numbers of students identified are being revised. This new data needs to be utilized when available.

6) Cost of Living:

The Task Force recommends that cost of living remain in total program, but the current methodology should be reviewed or revised. The state has never fully implemented the recommendations of the study that created this factor for the 1994 Act. Full implementation may be one consideration. Other suggestions include a more regional look at cost of living, or applying other indices used by the state such as the wage index that more accurately reflect the costs of school districts.

7) Transportation:

The Task Force recommends that transportation be considered as part of total program and the policy around transportation costs be given serious attention. Funding for transportation should be provided that takes into consideration the unique circumstances districts face in transporting students.

8) Small Attendance Centers:

The Task Force recommends there be an adjustment for small attendance centers that recognizes the financial need resulting from size and distances between schools and that this adjustment be included in total program.

9) Kindergarten:

The Task Force recommends that all kindergarten students be funded as a full time equivalents as part of total program. The research shows this is an investment in the future. This approach ensures consistency in funding and opportunity for all kindergarten students.

10)Preschool:

The Task Force recommends that funding for preschool be part of total program so districts will have the resources available for eligible students to access the programs needed. Districts should be allowed to provide their own services or contract out, which is the current methodology.

11) Public School Choice:

The Task Force recommends that an adjustment to total program funding be made to reflect the impact on school districts of public school choice. Choice includes online and charter schools, inter-and

intra-district open enrollment, as well as other options that may emerge in the future. Such impacts may include both those resulting from an immediate loss of student enrollment as well as those related to the ongoing oversight of choice programs. In addition, the school finance system must recognize and accommodate changing school structures that result from public school choice.

12) Other Considerations (based on district experience with various aspects of the formula)

The Task Force recommends:

- a) The student count should not become more cumbersome or require increased reporting for districts.
- b) The current count dates in October and December for special education students are workable.
- c) The pupil count process needs to be examined to address issues related to declining enrollment, student mobility and high growth districts.
- d) The inflation factor needs to be addressed to more accurately reflect the real costs borne by school districts. For example, this past year school districts experienced double-digit inflation in the costs of insurance, water and fuel while receiving an increase in funding that reflected 0.1% for inflation and an additional 1% from Amendment 23.
- e) The current limitation on school districts that desire to seek additional local revenues, with voter approval, should be increased by five percent.
- f) There should be an analysis of the adequacy of the school funding formula every 3 years to reflect legislative changes and educational reforms. This practice should ensure the financing system is reflective of costs needed for implementation.

RECOMMENDATIONS

II. State funding and laws for capital should ensure that all Colorado students attend school in safe and effective learning environments. This funding should be included within the state's school finance funding, but would be in addition to per pupil total program funding.

The Task Force believes that the State's responsibility for funding public school capital needs is similar to its responsibility for funding education programs. As a result, the Task Force believes the State ought to provide funding for capital projects in those instances when local districts and schools are unable to do so.

In order to meet its obligation to fund public school capital needs, the Task Force recommends the state:

- a) Assess the actual capital needs of public schools;
- b) Address the backlog of current capital needs⁴. Even before an assessment of all actual capital needs is completed, state funding for capital projects ought to be made immediately available in order to address health and safety risks at individual schools; and
- c) Provide future revenue to address ongoing capital needs.

The current method of funding school capital construction through local property taxes is

insufficient in that it undermines the state's ability to provide a thorough and uniform education through the distribution of state equalization funding by requiring that operating funds be directed from classroom expenditures towards capital projects. As a result of this, Colorado classrooms:

- a) Include learning environments for some Colorado students that fail to meet basic minimum health and safety requirements; and
- b) Include learning environments for some Colorado students that are insufficient to facilitate satisfaction of applicable state and federal student academic achievement and accountability requirements.

At a minimum, every public school facility should be free from basic health and safety defects and sufficient for purposes of meeting state content and academic accountability standards.

Other Considerations:

The Task Force recommends:

- a) The state should adopt a consistent definition of capital that includes the breadth of capital needs of public schools.
- b) The state should require that a standard method be used to identify and assess minimum adequacy standards for a safe and effective learning environment that incorporates:

- i) basic health and safety requirements;
- ii) graduation course requirements; and
- iii) other state and federal student academic requirements.

c) Funding for capital projects should be based upon the educational needs of students at each site or within each learning environment.

d) Funding and laws for capital projects should anticipate the particular circumstances of emerging and unique learning environments, such as use of technology, rural, online, charter and others which may not be appropriately considered when considering district needs.

e) Funding for capital projects should seek to maximize efficiencies by:

- (i) providing incentives or requirements that districts complete appropriate maintenance; and
- (ii) considering the full relative costs of new construction versus renovation.

The process of distributing grants for capital projects through a competitive process should be accompanied by adequate technical assistance to applicants in order to avoid:

- (i) disadvantage to small and rural districts; and
- (ii) awards being made to most effective grants as opposed to highest needs.

ADDITIONAL CONSIDERATION

Colorado should establish a P-16+ Council which is charged with exploring issues related to an integrated education system from preschool through higher education.

The public education funding challenge facing the state creates a unique opportunity for state policymakers to bring interested parties to the table to begin a discussion about the impact each part of the system has on the other. Among the issues that have funding implications for K-12 education are the following:

- a. Vocational education;
- b. Fifth year programs for high school students;
- c. Higher education admission standards;
- d. Teacher education programs; and
- e. Issues related to high school remediation and acceleration.

The Task Force recommendations already recognize the importance of preschool and full day kindergarten programs. The Task Force is forwarding the concept of a P-16+ Council as part of this report to express the group's willingness to work together with other members of the education community on issues of common concern. However, this invitation is not intended in any way to compromise important issues related to adequate funding for a K-12 public education system, which are the Task Force's top priority.

IV. Potential Funding Sources

The Task Force understands additional revenue will be required to accomplish the recommendations in this report. It is likely that multiple sources of revenue will be needed to get to the funding level we are suggesting. The Task Force conducted a brainstorming session on various revenues sources that could be explored further, assuming that the Interim Committee decides to address the significant lack of resources for public schools. The Task Force has not attempted to develop a consensus on which of these sources should be pursued, nor is the group advocating for any particular funding source. Before implementing any one funding source, individually or in combination with others, the legislature will have to carefully evaluate whom it would impact, whether it represents a short-term or long-term solution and what the consequences of it may be. Some of the suggestions can be done through legislation, others will require a vote of the people. The following potential sources of revenue are not in a priority order.

Revenue sources and issues for General Assembly:

1. Study the State's Tax Policy System

The State's current tax policy system has become handcuffed by a variety of conflicting constitutional amendments. The State should do a comprehensive study of state tax policy in order to provide equity to taxpayers throughout the State of Colorado and to provide the necessary resources to fund our State government.

2. Freeze the Local Mill Levy Used for School Finance (with hold harmless)

Local property tax mill levies determine the local share of property taxes that each of Colorado's 178 school districts provide as one of the component parts of the school finance act. The remainder of school finance funding comes from vehicle specific ownership taxes and the state budget. Due to the combined effects of TABOR and Gallagher, the local share of revenue has grown ever so slightly with the bulk of increased K-12 costs being funded by the state, putting further strain on the state budget. Freezing the local mill levies at current rates would stop or at least reduce future

exaggerations of that imbalance between state and local funding.

3. Change to Annual Reassessment of Property

Currently, property in Colorado is reassessed every two years. As a result, the local contribution to school funding is unable to fully capture any increase in property values during non-reassessment years. Working in combination with the freezing of the local mill levy, an annual reassessment of property would allow local taxpayers to pick up a higher share of the K-12 funding sooner and provide some relief to the state budget. Another alternative is to average the two years, which will lessen the saw-tooth fluctuations that occur now every two years.

4. Increase the Mill Levy Override Limit

One mechanism in the school finance act that allows local school districts to generate more funding is to submit a question to voters for additional local property tax revenue, called a mill levy override. This mechanism allows local taxpayers to approve an election question to allow the District to increase taxes in their district. The current limit of the mill levy override is 20% of Total Program Funding. Increasing this limit would allow local school districts to seek voter approval for additional funding. However, this raises issues about equity in the school funding system as it may exacerbate disparities in local funding.

5. Increase Revenue from School Trust Lands (Permanent Fund)

A long-term plan for optimization of the Permanent Fund includes providing the State Treasurer with more investment flexibility. This includes allowing the State Treasurer to invest in equities and also allowing the State Treasurer to pay back investment losses over a longer period of time beyond the current requirement of three years.

6. Securitize Tobacco Settlement Revenue

Securitization of the tobacco settlement would provide a guaranteed payment from the tobacco companies that would

be exempt from bankruptcy. While this funding is a non-recurring lump sum, it could allow for significant expenditures on non-recurring uses like capital construction.

7. **Seek Medicaid Reimbursement for Special Education Statewide**
Special education is one of the largest unfunded mandates on local school districts, putting a great strain on district budgets. One potential source of existing funds that could remedy this problem is the federal Medicaid reimbursement. Unfortunately, many districts, particularly rural and small ones, lack the resources to apply for these funds. If the State could coordinate Medicaid reimbursement on qualifying expenditures, the State could receive significant funding from the federal government to help cover some of the unfunded portion of special education costs.

Issues that must be submitted to voters:

8. **Address Disparate Mill Levies**

Another of the impacts of TABOR and Gallagher has been the creation of a wide disparity of mill levies assessed at one local school district compared to another depending on their localized combination of assessed valuation growth and enrollment growth. The result is that local school district mill levies can vary between four and 50 mills. This disparity has not only created some of the inequities in the current school finance act but has also led to the state shouldering more of the K-12 education funding burden. Legislation that would rebalance these mill levies could provide substantial relief to the state budget.

9. **Change the TABOR Revenue Limit Formula**

Changing the revenue limit formula would allow the State to recalculate its TABOR revenue limit and thus keep more revenues in the state budget.

10. **Provide Permanent Statewide Flexibility to Retain Revenues Above the TABOR Limit and Spend for State Programs**

Permanent statewide flexibility to retain and spend revenues

above the TABOR limit (also commonly known as de-Brucing) would allow for exemption of the State's revenue and expenditure limits without changing other provisions of TABOR, i.e. voter approval of tax increases, emergency reserves and election reform. At a minimum, this option should be considered because it is provided as an option under TABOR and has been exercised many times at the local level.

11. Repeal or Modify TABOR

Economic circumstances and programmatic needs have changed since TABOR's adoption in 1992. Adjustments to TABOR should be explored to repeal provisions in that voters may not even know exist, such as the double TABOR reserve requirement.

12. Implement a New Statewide Sales Tax Measure

Sales taxes in Colorado are generally assessed at the local level; however, many states use a state sales tax as a critical part of their state budget. A new statewide sales tax might provide the needed balance to buy the time for tax policy considerations while providing the resources to help address dwindling state resources.

13. Repeal or Modify the Gallagher Amendment

The Gallagher Amendment, which sets the balance of property taxes between residential and non-residential taxpayers, needs to be addressed by the State. The residential assessment rate has already dropped from 29 percent to less than eight percent. Conceivably, the residential assessment rate will eventually drop to less than 1%. As the residential assessment rate drops, local mill levies and property taxes for K-12 education will also continue to decrease. Unless this continual loss of revenue at the local level is addressed, the State will be required to cover this decreasing revenue through the school finance act.

14. Use State-Issued Bonding to Fund K-12 Capital Construction
While this concept requires a funding stream for debt service repayment, a state-issued bond would allow the State to address significant non-recurring expenditure requirements across the state. The proceeds of such an issue would be used to begin addressing the statewide backlog of K-12 capital funding needs.
15. Use Lottery Proceeds for K-12 Education
“Sin” taxes such as gambling, lottery, cigarette taxes and liquor taxes are often used in other states to fund K-12 education. There may be an opportunity to impose new taxes or reallocate existing lottery proceeds for the benefit of public education. Given the saturation of lottery proceeds on parks and prisons, it might be time to reevaluate the allocation of those proceeds and shift some lottery resources to K-12 education.
16. Make Structural Changes to the Colorado Tax Code
The Colorado tax code has significant structural issues and differences from the federal tax code. Modifying some of these structural issues could increase state income tax revenues.
17. Implement a Differential Real Estate Tax on 2nd Homes
Some states either assess or tax second homes differently than principal residences. Given Colorado’s large number of resort communities, combined with low property taxes relative to other states, a differential tax on 2nd homes could help provide some revenue relief to local districts and/or the State.
18. Implement a Dedicated Tax for Education
Colorado voters passed a constitutional amendment in 2000 (Amendment 23) to guarantee funding for K-12 education. The economic recession of the last few years combined with the depletion of the State Education Fund created by Amendment 23 has jeopardized the resources set aside by

voters for K-12 education. A dedicated tax to fund public schools, presumably to be restricted in the State Education Fund and not allowed to be diverted for other purposes, would allow for the State to meet voter intent and improve the Colorado's ranking in comparison to other states in funding K-12 education.

ENDNOTES

¹ See “Profile of Changes in Colorado Public School Funding 1988-89 to 2000-01,” prepared for the Colorado School Finance Project by Augenblick & Myers, Inc. (September 2002). According to the Profile, after adjusting for inflation (which rose by 52 percent between 1988-89 and 2000-01 based on the Denver-Boulder Consumer Price Index, the official state figure), central spending (for instruction, operation and maintenance of facilities, school and school district administration, and student and staff support) was \$379 per pupil, or \$263 million, lower than it had been in 1988-89. At that time, the gap represented a 14% loss in revenue compared to 1988 spending.

² See “Categorical Funding by School District,” a report by Deb Godshall, assistant director of the Colorado Legislative Council (August 30, 2005). This analysis indicates a statewide level of under funding in the following categorical programs for 2003-04:

Transportation	\$ 112,897,324
Special Education	\$ 376,444,403
English Language Learners	\$ 90,142,057
Voc Ed	\$ 66,831,020
Total	\$ 646,314,804

³ There is no question that over the past 15 years, Colorado spending on education has declined compared to its own past level of spending and relative to other states. Specifically, today Colorado ranks about 40th of the 50 states in spending, adjusted for regional cost-of-living differences, which is unusual for a state that ranks in the top 10 for median family income. Teske, *Stepping Up or Bottoming Out? Funding Colorado’s Schools*. Report from Donnell-Kay Foundation (January 2005).

⁴See “Calculation of the Cost of an Adequate Education in Colorado Using the Professional Judgement and the Successful School District Approaches,” prepared for the Colorado School Finance Project by Augenblick & Myers, Inc. (January 2003). Available at www.cosfp.org

⁵ In 2000, Colorado settled the claims made in *Alec Giardino, et. al. v Colorado State Board of Education, et. al.* (Denver District Court Case No. 98CV0246) by agreeing with the plaintiffs to provide \$190 million over an 11 year period for capital construction needs of school districts across the state. The Task Force’s recommendations that the backlog of capital projects be addressed is that such projects include both those required to be met under the *Giardino* settlement as well as others.

According to a 2003 State Auditor’s report, the backlog in school capital needs at that time was \$4.7 billion. *Public School Capital Construction Grant Program Colorado Department of Education Performance Audit*, Report of the State Auditor (May 2003).

In 2005, the Donnell-Kay Foundation undertook a needs assessment project that included a survey of all Colorado school districts and assessments by nationally renowned experts of schools in eight targeted school districts across the state. Those projects estimated the statewide backlog of school capital needs at between \$5.7 billion to \$10 billion. *Donnell-Kay, Colorado K-12 Capital Needs Assessment Project* (April 2005).

The range of \$5.7 to \$10 billion within the Donnell-Kay report reflects two different methods of estimating the actual costs. The \$10 billion is based upon applying the amount per pupil of capital projects backlog in 8 districts to the entire state pupil population. The amount of backlog in these 8 districts was based upon external site assessors estimates. The \$5.7 billion is based upon taking self-reported survey results from facilities managers in 72 districts. Donnell-Kay used these self-reported amounts to extrapolate the total need for the entire state based on each region’s student enrollment.

APPENDIX A

Charge to the School Finance Task Force

WHEREAS, Senate Joint Resolution 05-047 establishes a ten-member legislative interim committee to study the financing of public schools in Colorado; and

WHEREAS, said resolution charges the committee with studying the funding for students in public schools statewide, analyzing the needs of public school facilities throughout the state, and determining funding factors and formulas that should be adopted to ensure that all students in public schools in the state are receiving a thorough and uniform education in a safe and effective learning environment; and

WHEREAS, said resolution authorizes the appointment of a 16-member school finance task force to assist the interim committee in its work:

The committee hereby charges the school finance task force with studying and reporting to the committee on the following factors and issues:

- ◆ critical components of a school finance act that provide an equitable method of distributing adequate revenue to school districts, including a pupil count date and methodology that recognize staffing requirements for the school year and budgetary realities for declining and increasing enrollment school districts, statewide base funding, and adjustments to base funding that recognize cost differentials and differences in student populations among districts that affect the cost of providing educational services;
- ◆ the division of responsibility between the state and local district taxpayers for funding schools;
- ◆ the ability of school districts to collect property taxes with voter approval to enhance school district funding, whether such additional funding contributes to or detracts from an equitable and adequate financing system, methods to ameliorate any inequities that might be caused by the use of property taxes to enhance funding, and whether such additional funding should be limited, especially in light of the task force's recommendations for a school finance formula;
- ◆ statutory provisions for "earmarking": allocations for instructional materials and capital reserve and risk management funds, at-risk moneys, and preschool moneys;
- ◆ a mechanism for funding charter schools that will address the needs of both school districts and charter schools;
- ◆ a mechanism for funding supplemental on-line education courses that enrich the program offerings of school districts and that provide an alternative method for delivering services to special populations of students;
- ◆ categorical funding; and
- ◆ any other school finance issue of concern to the task force.

The committee further requests that the following considerations be included in the task force's work and reports to the committee:

- ◆ an analysis of the components of Colorado's current school finance system, including categoricals, to determine whether the components of the current system need to be addressed;
- ◆ options for modifications to Colorado's school finance system;
- ◆ the potential or need for a comprehensive rewriting of Colorado's school finance law; and
- ◆ specific recommendations for legislation or for ballot proposals.

The committee requests that the task force submit its recommendations to the committee by September 27, 2005.