LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 79TH LEGISLATURE 3rd CALLED SESSION - 2006

April 27, 2006

TO: Honorable Steve Ogden, Chair, Senate Committee on Finance

FROM: John S. O'Brien, Deputy Director, Legislative Budget Board

IN RE: **HB1** by Chisum (Relating to public school finance, property tax relief, and related matters; making an appropriation.), **As Engrossed**

Estimated Two-year Net Impact to General Revenue Related Funds for HB1, As Engrossed: a negative impact of ($2,393,350,000) through the biennium ending August 31, 2007.

Appropriations:

Fiscal Year	Appropriation out of *FOUNDATION SCHOOL FUND* 193
2006	$0
2007	$2,385,800,000

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2007	($2,393,350,000)
2008	($2,478,550,000)
2009	($2,540,050,000)
2010	($2,630,150,000)
2011	($2,650,150,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable Savings/(Cost) from *GENERAL REVENUE FUND* 1	Probable Savings/(Cost) from *FOUNDATION SCHOOL FUND* 193	Probable Revenue Gain/(Loss) from *School Districts*
2007	($7,550,000)	($2,385,800,000)	($1,705,400,000)
2008	($3,350,000)	($2,475,200,000)	($1,433,900,000)
2009	($3,350,000)	($2,536,700,000)	($1,156,600,000)
2010	($3,350,000)	($2,626,800,000)	($858,200,000)
2011	($3,350,000)	($2,646,800,000)	($537,400,000)

Fiscal Analysis

The bill provides state aid to school districts in the 2006 tax year (2007 fiscal year), in amounts equivalent to a reduction to their nominal maintenance and operations (M&O) tax rate at 88.67 percent of the M&O rate adopted for the 2005 tax year - hereafter referred to as the "buydown" rate. For example, for a district taxing at $1.50 per $100 of valuation, this yields a buydown rate of $1.33. The bill then entitles districts to state aid sufficient to guarantee state and local revenue per student in weighted average daily attendance (WADA) in an amount equal to the greater of (1) what the district would be entitled to in the 2006-07 school year under current law, or (2) 2006 revenue per WADA, including state aid districts received for property value decline and wealth-sharing arrangements. For a district subject to recapture, the additional revenue it is entitled to receive to maintain this revenue target may be received as a downward adjustment to its recapture payment.

In the 2006 tax year (2007 fiscal year), a district's rollback rate (prior to the addition of the current debt rate) is calculated as their effective M&O buydown rate (the rate that would generate the same amount of state and local M&O revenue per WADA as available in the preceding year), plus six pennies, but not to exceed $1.36. In the 2007 tax year and beyond, the rollback rate for a district who in the 2006 tax year adopted a rate less than $1.36 is set at the lesser of their effective M&O tax rate plus six cents or $1.36; the rollback rate for a district who in the 2006 tax year adopted a rate of at least $1.36 is set at the lesser of their highest adopted M&O tax rate, or their effective M&O rate plus six pennies. The bill contains an equivalent rollback provision for districts currently permitted under special law to tax in excess of $1.50. Rates adopted beyond the rollback rate are subject to a rollback election.

Total revenue is guaranteed to districts via an increase to the current law funding formulas (Basic Allotment, Guaranteed Yield and Equalized Wealth Level) to the extent that those increases do not exceed the appropriation of $2,385.8 in the legislation. The remainder of the target revenue amount is provided via a hold harmless provision. Pennies of tax effort in excess of the buydown rate remain part of Tier 2 in the Foundation School Program, and thus eligible to the same guaranteed yield as pennies below the buydown rate.

The bill provides to the Texas School for the Blind and Visually Impaired and the Texas School for the Deaf state aid in an amount that would hold them harmless against the loss in local district tax revenue. The bill also requires districts participating in Tax Increment Financing (TIF) agreements to pay the same amount into a TIF fund as if the tax rate were the amount levied in 2005, and directs the Comptroller to deduct for this marginal TIF payment from the district's recognized taxable value.

Article II of the bill establishes a number of fiscal accountability measures. These provisions include the creation of education research centers, direction to the Texas Education Agency (TEA) to improve accessibility to the Public Education Information Management System, creation of a "best practices" clearinghouse and establishment of TEA-determined school district spending targets. The bill directs the Commissioner to use available federal funds to support these new requirements. It is assumed that federal funds available to TEA are already obligated for other purposes and that an expenditure of general revenue would be required either to fund the programs currently funded with federal funds or to support the programs in Article II.

The bill makes an appropriation of $2,386 million in fiscal year 2007 to the Texas Education Agency for distribution to school districts to satisfy the requirements of the bill.

Methodology

In fiscal year 2007, this bill results in a total net state cost estimated to be $2,361 million, however, the appropriation of $2,386 million exceeds that cost. Of this amount, approximately $2,148 million represents the equivalent of a dollar-for-dollar replacement of state aid for local revenue in the school finance system. While the bill provides for an increase to the Foundation School Program's funding formulas, those changes are only allowed to the extent that they would not increase the overall appropriation made in the legislation. Therefore, costs in FY 2007 could reach the appropriation amount, depending on the Commissioner's determination of availability. The formula increases appear to be constrained in the out years by the stipulated sum-certain appropriation amount. However, if the appropriation limitation is only intended to apply in FY 2007 then any formula increases made in FY 2007 would drive higher costs in FY 2008 and beyond, particularly in application to enrichment pennies.

Other provisions in the calculation of a district's revenue target -- guaranteeing the higher of 2007 current law revenue or 2006 revenue per WADA, allowing districts to include revenue gained in excess of entitlement from wealth-sharing arrangements, and including revenue for property value decline -- add approximately $65 million in state costs in 2007.

The provision allowing districts to access pennies above their buydown rate results in additional local revenue and state costs. For fiscal year 2007, it is assumed that districts, on a statewide average basis, access the equivalent of four pennies above their buydown rate. The state guaranteed yield on these four pennies results in a state cost of $175 million offset by recapture revenue for a net state cost of 126.9 million. Local retained revenue increases by $442 million.

The bill's reduction in district local revenue, combined with the effect of netting out a district's recapture payments against its hold harmless revenue guarantee, reduces recapture payments statewide from an estimated $1.8 billion to approximately $1.2 billion in 2007.

After fiscal year 2007, net state costs of the bill increase, driven by districts accessing additional pennies above their buydown rate. The total net state cost of the bill increases by approximately $100 million in each year after fiscal year 2007, with a net state cost in 2011 estimated to be $2,650 million. State aid increases in the out years are primarily due to the assumption of increasing tax effort above districts' buydown rate. On top of the assumption of a statewide average of four pennies in 2007, it is assumed that districts will add another 3 pennies of tax effort in each year of 2008 to 2011. The Tier 2 state cost impact of these additional pennies is limited by the projection that districts will begin hitting the effective tax rate cap of $1.50 in increasing numbers in the years after 2007, and by the state fiscal benefit due to increase in recapture collected on additional pennies levied by recapture districts.

Out year increases are also enhanced by a revenue benefit certain districts gain by using 2006 revenue per WADA as their revenue target, but are somewhat offset by the bill's revenue target calculation which limits the revenue benefit certain districts otherwise would receive from property value increases.

The state cost to hold the School for the Blind and Visually Impaired and the School for the Deaf harmless for the loss of school district revenue is estimated to be approximately $200,000 annually. The state aid increase due to the recognition of district payments into a TIF fund as required by the bill are estimated to be $14 million in 2007, increasing by roughly 17 percent each year thereafter.

Provisions in the bill requiring implementation of certain fiscal accountability measures are estimated to cost $7.6 million in FY 2007, dropping to $3.4 million in FY 2008 and thereafter.

Technology

The fiscal accountability provisions of the bill will require the Texas Education Agency to review and revise the Public Education Information Management System data, and also create a "best practices" clearinghouse. These provisions will have a technology impact to the Texas Education Agency.

Local Government Impact

School districts would see a decrease in local revenue due to the bill's tax rate reduction and an increase to state aid due to the bill's revenue guarantee provision.

Districts' local revenue loss from an 11.33 percent tax rate reduction is estimated to be $2,148 million in 2007, increasing by 4-5 percent each year thereafter. However, for the purposes of the fiscal note it is assumed that districts would access, on a statewide average basis, the equivalent of four pennies above their buydown rate in 2007, which would generate an estimated $442 million in retained local revenue, resulting in a net local revenue loss of approximately $1,705 million. These pennies also would generate an estimated $127 million in state aid. In fiscal year 2008, under the assumption of seven additional pennies over the buydown rate (the four levied in 2007 and another 3 in 2008), the local revenue loss prior to enrichment of $2,333 million would be offset by a gain of $799 million in retained local revenue on those seven pennies. For 2009 to 2011, it is assumed that districts would add an average of three pennies each year, with corresponding impacts to local revenue and state aid.

Source Agencies: 304 Comptroller of Public Accounts

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