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Equalization Aid Formula (DPI -- General School Aids and Revenue Limits)

CURRENT LAW

The current three-tiered equalization aid formula was enacted in 1995 Act 27 and first applied to aid paid in 1996-97. The equalization aid formula is calculated using school district data (membership, shared costs, and equalized valuations) from the prior school year. There are three guaranteed valuations used in the equalization formula that are applied to three different expenditure levels.

The primary tier is for shared costs up to the primary cost ceiling of $1,000 per member. State aid on these primary shared costs is calculated using a statutorily guaranteed valuation of $1,930,000 per member, and is based on a comparison of the school district's equalized valuation per member to the $1,930,000. State aid equals the amount of costs that would be funded by the missing portion of the guaranteed tax base. Every district whose equalized valuation per member is below $1,930,000 receives at least the primary aid amount; primary aid cannot be reduced by negative aid generated at the secondary or tertiary aid levels. This feature of the formula is referred to as the "primary aid hold harmless."

The secondary tier is for shared costs that exceed $1,000 per member but are less than the secondary cost ceiling, which is equal to $7,679 in 2004-05. The secondary cost ceiling is set equal to 90% of the prior year statewide shared cost per member. The state's sharing of secondary costs is calculated using the secondary guaranteed valuation. The secondary guarantee is not set statutorily, but is placed at a level that generates equalization aid entitlements that are equal to the total amount of funding available for distribution. In 2004-05, the secondary guaranteed valuation is $1,030,488.

The tertiary tier is for shared costs that exceed the secondary cost ceiling of $7,679 per member in 2004-05. State aid on tertiary shared costs is calculated using the statewide average equalized valuation per member, which is $407,263 in aid year 2004-05. If a school district's tertiary aid is a negative number, this amount is deducted from its secondary aid. As noted above, if

the sum of a district's secondary and tertiary aid is a negative number, this amount is not deducted from its primary aid amount.

GOVERNOR

Maintain the current law three-tiered equalization aid formula.

DISCUSSION POINTS

1.	Under AB 100, an additional $285 million in 2005-06 and $415 million in 2006-07 would be provided for general school aids. Given the magnitude of the increase in general aid proposed, the Committee could also choose to make modifications to the equalization aid formula as well. While there are numerous modifications the Committee could make, this paper will deal with the following features of the formula: (a) the primary aid hold harmless; (b) the primary guarantee; (c) negative tertiary aid; and (d) the secondary cost ceiling.

2.	The equalization aid formula operates under the principle of equal tax rate for equal per pupil costs, or tax base equalization. In pure form, this means that a school district's property tax rate does not depend on the property tax base of the district, but rather depends on the level of costs. Thus, there is an inverse relationship between equalization aid and property valuations; those districts with low per pupil property valuations receive a larger share of their costs through the equalization formula than districts with high per pupil property valuations. The purpose of this policy is to minimize the differences among school districts' abilities to raise revenue for educational programs.

3.	School districts can be placed in one of five equalization aid categories depending on their per member costs and value:

•	"Positive secondary aid districts" have primary and secondary costs only and an equalized value per member that is below the secondary guarantee. Districts in this category will receive positive aid at the primary and secondary levels.

•	"Positive tertiary aid districts" have primary, secondary, and tertiary costs and an equalized value per member that is below the tertiary guarantee. Districts in this category will receive positive aid at the primary, secondary, and tertiary levels.

•	"Negative tertiary aid districts" have primary, secondary, and tertiary costs and an equalized value per member that is between the secondary and tertiary guarantees. These districts receive positive aid at the primary and secondary levels, but the positive secondary aid is partially offset by negative aid generated at the tertiary level.

•	"Primary aid only districts" have an equalized value per member that is between the primary and tertiary guarantees. These districts receive positive aid at the primary level but

generate negative aid overall at the secondary and/or tertiary levels. Under the primary aid hold harmless, these districts receive their primary aid amount.

• "Special adjustment aid districts" have an equalized value per member that exceeds the primary guarantee, and generate negative aid at all levels of the formula. As a result, they do not receive equalization aid, but qualify for special adjustment (hold harmless) aid.

Primary Tier

4. Prior to 1996-97, equalization aid was distributed using a two-tiered formula that was similar to the secondary and tertiary levels of the current formula. Under the prior formula, minimum aids were provided to school districts which were either not eligible for equalization aid or which received very low payments per pupil. The minimum aid amount varied from $175 to $400 per pupil, based on a district's median household income and property tax levy rate.

5. The current three-tiered cost sharing formula was enacted in 1995 Act 27 and first applied to equalization aids paid in 1996-97. Under that act, minimum aids were eliminated and the primary tier was added to the formula. The primary guarantee was initially set at $2,000,000 per member. Under 2001 Act 109, the primary guarantee was reduced to $1,930,000 per member, effective with the 2002-03 equalization aid distribution.

6. The primary tier of the formula was added to ensure that all school districts would receive some portion of equalization aid funding when an increase of over $800 million was provided in equalization aid between 1995-96 and 1996-97 as the state began funding two-thirds of partial school revenues. Had the prior two-tiered formula remained in effect as the state moved to two-thirds funding, several districts would have remained ineligible for equalization aid under that formula, because their value per member would have exceeded the highest guaranteed valuation in the formula.

7. In 2004-05, 37 school districts are affected by the primary aid hold harmless provision of the equalization aid formula. Under current law, these districts, which have relatively high property value per member, are entitled to the amount of aid generated at the primary level.

8. Of those 37 districts, 26 received special adjustment aid in addition to the aid generated at the primary level of the equalization aid formula in 2004-05. Thus, these districts' aid amounts would not have been affected by the elimination of the primary aid hold harmless provision had it been effective in 2004-05, because they would still have received 85% of their prior year general school aid payment. Under an alternative to eliminate the primary aid hold harmless, however, these districts could eventually lose aid compared with payments they would have received under current law, if the 85% special adjustment aid payment is less than the primary aid entitlement the districts would have been eligible for under the primary aid hold harmless.

9. The other 11 districts did not receive special adjustment aid in 2004-05. Had the primary aid hold harmless been eliminated in 2004-05, these districts would no longer have

received equalization aid. Instead, they would have received special adjustment aid equal to 85% of their prior year general school aids amount. For these districts, that special adjustment aid amount would be less than the primary aid generated under the equalization aid formula in 2004-05.

10.   To further equalize the distribution of aid under the formula, the Committee could choose to delete the primary aid hold harmless provision. This would redirect equalization aid dollars from property-rich districts to property-poor districts, and arguably better reflect the intent of the equalization aid formula to equalize the tax base among districts.

11.   Had there been no primary aid hold harmless provision for the 2004-05 general school aids distribution, approximately $1.8 million (0.04% of the $4,317.5 million appropriation) would have been redistributed between school districts. The 11 districts previously mentioned would, in total, have received $1.8 million less in aid, which would have been redistributed among 366 other districts. Aid payments to 49 districts would have remained unchanged.

12.   It could be argued, however, that the primary aid hold harmless is a feature of the formula that guarantees that all districts receive some funding from general school aids, regardless of the property wealth of the districts. As such, it could be viewed as desirable to maintain this aspect of the formula.

13.   When the primary tier was implemented, it was set at a level that provided an equalization aid entitlement to every school district. Currently, five districts (Boulder Junction J1, Gibraltar Area, Linn J6, Phelps, and Washington) have a per-pupil property valuation greater than the primary guarantee and thus do not generate any equalization aid entitlement. If the primary tier is intended to recognize that every community contributes to the general fund and should thus receive some level of equalization aid, it could be argued that the $1,930,000 primary guarantee per pupil is too low.

14.   For example, had the primary guarantee been set at $6,000,000 per pupil for the 2004-05 aid distribution, all districts would have generated an equalization aid entitlement. Nearly $9.9 million (0.23% of the $4,317.5 million appropriation) would have been redistributed among school districts, with 35 districts receiving more aid than under current law and 364 districts receiving less. Aid for 27 districts would have remained unchanged. In addition to the districts that currently receive no equalization aid, most of the districts that would have received additional aid are relatively property-rich districts subject to the primary aid hold harmless provision. A few property poorer districts with relatively low shared costs per member would also have received more aid.

15.   To the extent that increasing the primary guarantee would provide more aid to relatively property-rich districts, it could be argued that it runs counter to the intent of the formula to equalize the tax base of school districts in the state. Further, given that the primary guarantee was decreased from $2,000,000 to $1,930,000 per member in 2001 Act 109, increasing it would be inconsistent with recent actions of the Legislature to distribute less aid on this level of the formula.

Finally, higher value school districts receive funding from state categorical aids and the school levy tax credit, which benefits property taxpayers in school districts. As a result, these school districts receive some measure of support from the state even if they no longer receive equalization aid. For example, the estimated percentage of state support of partial school revenues in 2004-05 for the school district with the lowest value per member is 85.5% while the highest value district still receives 20.6% state support.

Secondary and Tertiary Tier

16.   The tertiary guarantee feature of the equalization aid formula is intended to serve two purposes. First, it is meant to serve as a disincentive for higher spending levels by causing districts to receive aid at much lower levels for costs incurred above the ceiling, or lose aid attributable to those costs if a district's per member equalized value is greater than the tertiary guarantee. Second, it attempts to narrow the per pupil spending disparities among school districts by redistributing aid to districts that spend at lower levels.

17.   It could be argued that having a tier with a lower guarantee may have better served those purposes prior to the imposition of revenue limits in 1993-94. When there were no direct limits on the amount a school district could levy, providing less aid to higher-value, higher-spending districts was an indirect way to attempt to limit spending and narrow revenue disparities among districts. Under revenue limits, the annual increase in a school district's per pupil revenue derived from general school aids, computer aid, and property taxes is restricted. Revenue limits thus serve as a direct control on district spending, and certain features of revenue limits (such as the low-revenue ceiling and the flat dollar adjustment per pupil for all districts) serve to directly narrow the disparities between high- and low-revenue districts.

18.   Under revenue limits, the effect for each of the five types of districts of spending an additional dollar, once it is aided through the equalization formula, differs. Because the equalization aid formula uses prior year data, in the first year, the district's aid is unaffected by any increased spending, and the district must fund spending dollar-for-dollar. After the first year, the following points provide examples of possible effects.

•   A positive secondary district that receives 60% aid at the secondary level, for example, would receive 60¢ of equalization aid for an additional dollar of spending, and thus have to levy for the remaining 40¢ under revenue limits to support that additional $1 of spending.

•   A positive tertiary district might receive less aid at the tertiary level, 15% for example, and would receive 15¢ of aid for an additional dollar of spending. This district would have to levy 85¢ under revenue limits to support that additional $1 of spending.

•   A negative tertiary district that is aided at -30%, for example, at the tertiary level would lose 30¢ of aid for an additional dollar of spending. This district would have to levy $1.30 under revenue limits to support that additional $1 of spending.

•   A primary aid only or special adjustment aid district would generate some level of

negative aid entitlement for an additional dollar of spending, but this additional negative aid entitlement would not affect the amount of aid actually received by the district. Because these districts already generate negative aid at other levels of the formula that causes them to receive either their primary aid amount or no aid, this district would have to levy $1 under revenue limits to support an additional $1 of spending.

19.   One can argue that the equalization aid formula unfairly disadvantages negative tertiary aid districts. Districts that have lower property value per pupil than the negative tertiary aid districts receive some state aid for additional spending. Districts with the highest per pupil property values in the state generally need to levy only dollar-for-dollar for additional spending. Only negative tertiary aid districts, which have property value per pupil above the statewide average, but not too high above the average, face the situation of having to levy more than a dollar for an additional dollar of spending.

20.   Many school districts affected by negative tertiary aid believe that the state should allow for a some deduction of certain expenditures from the calculation of shared costs in order for these school districts to be able to fund additional projects without what can be perceived as a state aid penalty. Further, some negative tertiary districts argue it is not fair to ask voters in the district, when considering a referendum, to have to increase their levy by more than a dollar for the district to be able to spend a dollar.

21.   One option for addressing this concern would be to specify that any additional expenditures authorized by a referendum passed on or after the effective date of the budget bill could be excluded from shared costs for the calculation of a school district's equalization aid if the result of excluding such debt service or operating costs would be an increase in the equalization aid payment to the district. This would allow negative tertiary districts to be able to be treated similarly to districts with generally higher property values for a relatively limited class of expenditures. Because a referendum would have to be approved by the voters in the district, this option would ensure that local voters support the district's decision to spend or tax at higher levels, before it could occur.

22.   Under this provision, equalization aid could be shifted from lower-value to higher-value districts for costs attributable to such referenda, if they would have been offered and passed under current law. However, there is no way to estimate how much aid would be redistributed or how many districts would gain or lose aid, because any aid redistribution would depend on which referenda passed in districts that otherwise would not have passed or not have been offered. To the extent that aid would be redistributed, it would arguably run counter to the equalizing intent of the formula.

23.   Under current law, school district general fund and debt service fund expenditures are included in a district's shared cost. Under this alternative, certain operations and debt service costs would be treated differently with respect to aid. It may be desirable to treat all classes of expenditures in the same manner under the equalization aid formula; from this point of view; exceptions to this treatment should not be made for any districts.

24.	An alternative that may have fewer disequalizing effects than allowing an optional deduction for certain shared costs would be to increase the secondary cost ceiling to 100% of the prior year statewide shared cost per member. This would increase the amount of shared costs that would be aided at the secondary level and reduce the amount of shared costs that would be aided at the tertiary level of the equalization aid formula. Because districts would receive a greater share of their costs from the state at the secondary than the tertiary aid level, many districts could be assisted by an increase in the secondary cost ceiling.

25.	The secondary cost ceiling was set at 90% of the prior year statewide shared cost per member in the 2001-03 budget act. Prior to that, it was adjusted annually for inflation each year. In the years immediately preceding the 2001-03 budget, the secondary cost ceiling was generally higher than 90% of the prior year statewide shared cost per member, although it was declining as a percentage of the prior year statewide shared cost per member. Had the prior law inflation adjustment still applied, the secondary cost ceiling would have been an estimated 84.5% of the prior year statewide shared cost per member in 2004-05.

26.	It could be argued that costs at or below the statewide average shared cost per member should be aided at the more generous secondary level, and only if costs exceed the statewide average per pupil amount should districts be penalized with a lower aid rate or negative aid. Setting the secondary cost ceiling at 90% of the statewide average penalizes some districts for costs that are below average. It is unclear whether the equalization aid formula should be structured to offer a disincentive to spending that starts at only 90% of prior year statewide average costs.

27.	On the other hand, increasing the secondary cost ceiling would hamper the cost controlling effects of the tertiary aid level and would redistribute state aid from school districts with per pupil costs below the current secondary cost ceiling to districts with higher costs. One can argue that districts, such as those subject to negative tertiary aid, should be encouraged to decrease their costs to a level closer to the current secondary cost ceiling, rather than adjusting the formula in such a way that would benefit higher-cost school districts.

28.	Based on data used to calculate 2004-05 general school aids, if the secondary cost ceiling had been set at 100%, rather than 90%, of the prior year statewide shared cost per member, $52.7 million (1.2% of the $4,317.5 million appropriated) would have been redistributed among school districts. A total of 259 school districts would have gained aid, 118 would have lost aid and 49 would have been unaffected by this modification. Generally, aid would have been redistributed from lower-cost, lower-value districts to higher-cost, higher-value districts. However, high-cost, low-value districts also would have gained state aid.

29.	It may be beneficial to the tax base equalization goals of the school aids formula to maintain current law. Allowing a deduction from shared costs for negative tertiary aid districts would benefit the school districts in the state that have a greater advantage in raising local revenue and would divert state aid from the school districts in the state with the least ability to raise revenues to meet educational costs. While increasing the secondary cost ceiling would not include as many disequalizing outcomes, it may be desirable to maintain the current incentive structure of a

secondary cost ceiling set at lower-than-average costs.

30.   It could be argued that no change should be made to the formula, given that the Supreme Court has found it constitutional. The most recent decision by the Court on the constitutionality of the school aid formula was issued in July, 2000, in the case of <u>Vincent v. Voight</u>. In that decision, the Court concluded that the current state school finance system did not violate either the uniformity clause or the equal protection clause of the Wisconsin Constitution. The Court also held that the current school aid system more effectively equalizes the tax base among districts than the system upheld as constitutional in the previous school finance decision of the Court in 1989 (<u>Kukor v. Grover</u>).

ALTERNATIVES

Adopt one or more of the following:

1.   Delete the primary aid hold harmless provision of the equalization aid formula, beginning with aid paid in the 2005-06 school year.

2.   Increase the primary guarantee to $6,000,000 per member for K-12 districts, adjusted proportionately for K-8 and UHS districts, beginning with aid paid in the 2005-06 school year.

3.   Beginning with equalization aid paid in the 2006-07 school year, specify that the cost supported by additional revenues authorized and levied under a debt or operating referendum approved by the voters after the effective date of the budget bill would be excluded from shared costs if the result would be an increase in the district's equalization aid payment.

4.   Beginning with equalization aid paid in the 2005-06 school year, specify that the secondary cost ceiling of the equalization aid formula would equal 100% of the prior year statewide shared cost per member.

5.   Maintain current law.

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