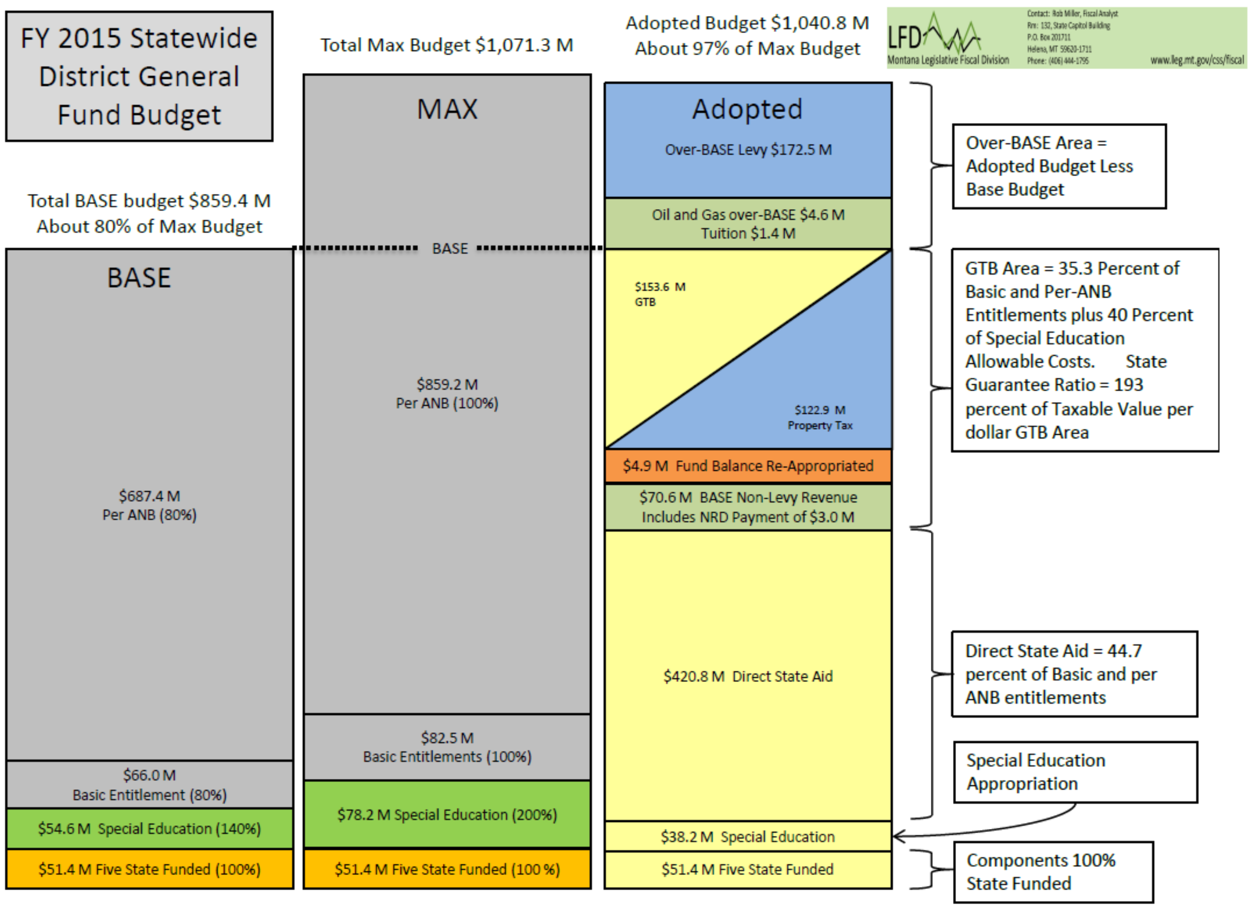
Options for Equalizing BASE Mills

prepared for the School Funding Interim Commission
by Pad McCracken, Research Analyst, March 2016

Montana's current school funding formula establishes a minimum or BASE (Basic Amount for School Equity) limit for each school district's general fund (GF) budget, and through a blend of state funding, permissive (nonvoted) local property tax levies, and nonlevy revenue, each district reaches, at a minimum, this BASE level. Districts that are eligible for guaranteed tax base aid (GTB) may receive a per mill subsidy from the state as a way of equalizing disparities in local property tax wealth. Figure 1 may provide a graphic refresher of how GF budget limits are established (the two columns to the left) and how GF adopted budgets are funded (the center-right column).

Figure 1



The term "BASE mills" refers to the number of mills a district levies (if needed) to reach the BASE limit. Some districts do not levy BASE mills due to the amount of nonlevy revenue they generate. Districts with higher taxable valuations per ANB generally levy fewer mills than those with lower taxable valuations per ANB, though again GTB helps address this disparity. Figure 2 contains information about the number of BASE mills levied in fiscal year 2016 based on district budget information (OPIBUD16).

Figure 2

Type	Low BASE Mills	High BASE Mills	Mean BASE Mills	Median BASE Mills
EL[1]	0 (6 districts)	54.0	32.4	36.6
HS	0 (4 districts)	28.1	18.0	20.2
K-12	0 (3 districts)	79.9	47.5	51.3

As you can see, despite the equalizing mechanism of GTB, wide ranges in the number of BASE mills exist. During the breakout sessions at the January meetings, concerns were raised about taxpayer equity and possible financial disincentives to voluntary district annexation or consolidation. Participants discussed means by which mill levies could be equalized, and since BASE mills are in essence *required* mills, mandated through the state funding formula, the discussion focused on ways to further equalize BASE mills.

Several possible means of equalizing BASE mills will be explored below, each of which entails complicated adjustments to our current formula and financial models. This brief will provide an overview and some considerations for the following possibilities:

- county equalization with GTB subsidies for lower wealth counties;
- statewide equalization of BASE mills;
- elimination of BASE mills; and
- modifications to the current BASE GTB calculations.

If the commission is interested in pursuing any of these options further, we can provide more detailed information about the effects at the May commission meeting.

It is worth noting that equalization, unless it is accomplished through a new infusion of state money, means that some districts will levy more mills than they are currently levying and some districts will levy less. It may also mean that different classes of property will pay more or less. In legislative parlance, there will be "winners and losers." Also, it will be necessary to discuss the role that nonlevy revenue plays in any of these options. For some sources of nonlevy revenue, districts decide how much to allocate to the district general fund BASE budget, and this flexibility may add complications to the possibilities discussed below.

County Equalization of BASE Mills with GTB

This option may be easier to visualize when remembering that district retirement mills are equalized at the county level and are subsidized via GTB, meaning the basic framework for this possibility already exists:

1. Districts within a county determine what their costs for employer retirement contributions will be for the upcoming year.
2. Retirement costs for joint districts with territory in multiple counties are assigned to each county based on the proportion of students of the district residing in each county.
3. The county superintendent adds up all of the districts' retirement costs, subtracts various forms of nonlevy revenue available, and calculates the mill levy required to generate the difference after factoring in the GTB mill subsidy if the county is eligible.

[1] For these calculations, elementary BASE mills do not include the nonisolated mills levied by seven districts.

Applying this framework to BASE mills would mean that each district would determine the amount it needs to fund its general fund budget to the BASE level, after accounting for the state payments (direct state aid, special education payment, five state payments; see the right-hand column of Figure 1) and applicable nonlevy revenue. These amounts would be totaled at the county level, and the county superintendent would calculate the countywide BASE levy while factoring in a GTB mill subsidy if the county is eligible.

Under this scenario, taxpayers in districts with low BASE mill levies currently would likely pay more, whereas those with higher BASE mills would see a decrease. In essence, the foundational costs of educating children (represented by the BASE budget) would be borne by all property taxpayers within a county equally, as the term "county equalization" implies. Districts would still be responsible for any over-BASE budget they adopt. If the state wanted to mitigate the cost increases to some taxpayers, policymakers could do this by increasing the GTB subsidy, in effect "lifting all (or most) boats." This would require additional state expenditure.

Statewide Equalization of BASE Mills

Statewide equalization of BASE mills takes the previous option a step further. The amounts needed to bring every district to the BASE budget level (after state payments and nonlevy revenue are factored in) are totaled at the state level, and property tax levies are calculated based on statewide taxable valuation. As BASE mills are equalized at the state level, variations in property tax wealth between districts (or counties) are irrelevant and GTB (for BASE levies) is not necessary.

One important consideration with both county and statewide equalization of BASE mills is that in addition to winners and losers in terms of lower and higher mills based on geography, there are also winners and losers based on property tax classifications. Certain classes of property are often concentrated in a school district and may greatly increase that district's taxable valuation, which in turn would lead to lower mill levies. When equalization happens at the county or state level, certain classes of property see higher and lower mill rates. For a detailed explanation and analysis of these effects broken down by county and on different property classes, see this 2005 memo on equalizing school mills statewide prepared for the Quality Schools Interim Commission:
http://leg.mt.gov/content/Committees/interim/2005_2006/qual_schools/staff_reports/Updated_Copy.pdf

Elimination of BASE Mills

Another means of equalizing BASE mills would be to eliminate them entirely by increasing the percentages of the basic and per-ANB entitlements paid for through direct state aid from 44.7 percent to 80 percent (remember that *BASE budgets* are established at 80 percent of the basic and per-ANB entitlements and 100 percent of these entitlements is used to establish *maximum budgets*). As shown in Figure 1, if direct state aid was increased to 80 percent of these entitlements, it would cost the state $753.4 million rather than $420.8 million (based on FY 2015 figures), or $333 million more. However, the state would not need to spend $153.6 million on GTB and could reconsider its use of nonlevy reimbursements, such as block grants, which were nearly $60 million in FY 2015. Obviously, this would increase the "state's share" of district general fund budgets significantly and require new state revenue or spending reductions elsewhere to accomplish.

Modifications to the Current BASE GTB Calculations

As stated before, guaranteed tax base mechanisms are intended to equalize disparities in district property tax wealth. In their pure form, these mechanisms establish a "floor," or a minimum mill value, based on need. Typically, the number of students is used as a proxy for need, but Montana's BASE GTB is based on a ratio of taxable value compared to what is called "the GTB area" of a district's GF budget. You can think of this as a district's revenue capacity (TV) compared to its budgetary need (GTB area). If a district's TV/GTB area is lower than the state ratio guarantee or floor, the district is eligible for a per mill GTB subsidy.

One issue with Montana's current GTB calculations is that the GTB area is defined as that area of a district's BASE budget not filled by direct state aid, the special education payment, and the five state payments (see the right-hand column of Figure 1) and therefore a district's "need" is determined *independent* of the amount of nonlevy revenue the district receives. So a district that generates a large amount of nonlevy revenue is eligible for the same per mill GTB subsidy as a district with identical wealth and need that generates little nonlevy revenue. The latter district would still receive more GTB aid from the state because it has more "need" to fill and therefore levies more mills, but the equalizing power of GTB is diminished because the calculations for the ratios ignore nonlevy revenues, which are generated unevenly among Montana's 400 or so districts.

Another way to state this is that if Montana's GTB calculations were modified to factor in districts' nonlevy revenue, then statewide all districts would appear less needy and the state guarantee ratio would increase. There would be a higher threshold for receiving GTB aid. Individual districts would also appear less needy, *but to varying degrees* based on the amount of nonlevy revenue they generate. Those that generate proportionally more nonlevy revenue might no longer be eligible for the GTB subsidy, but those that generate proportionally less nonlevy revenue would be eligible for higher GTB subsidies per mill. The net effect would be a greater equalization of BASE mills.

Decreasing DSA; Increasing GTB

This option might be easier to grasp by looking back at Figure 1 on page 1. If the direct state aid (DSA) percentage was reduced from 44.7%, the GTB area would increase correspondingly. All districts would receive less DSA, but needier districts would receive more GTB. To keep the state share of district general fund budgets stable and the change revenue neutral for the state, the GTB multiplier could be increased from 193%. Equalization of BASE mills would increase through higher property taxes in less needy districts with low BASE mills currently. This change combined with the inclusion of nonlevy revenues in GTB calculations described above would equalize BASE mills even more.

Next Steps

This brief has provided an introduction to several options that exist for equalizing BASE mills. Staff will walk through these options at the April commission meeting and possibly provide more detailed information on the financial impacts. If the commission is interested in pursuing one or more of these options further, we can gather additional information for the May commission meeting.

cl0170 6069pcdc.docx