K-12 Education Funding Whitepaper

(April 2019)

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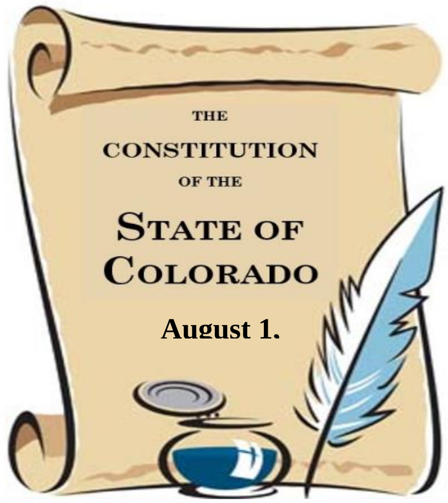
Overview of K-12 Education Funding

Funding Colorado’s K-12 education system is one of the primary responsibilities of our state government and is embedded into our original state constitution. As a requirement of statehood to be admitted into the Union, Colorado had to demonstrate that it provided for a system of free and public education.

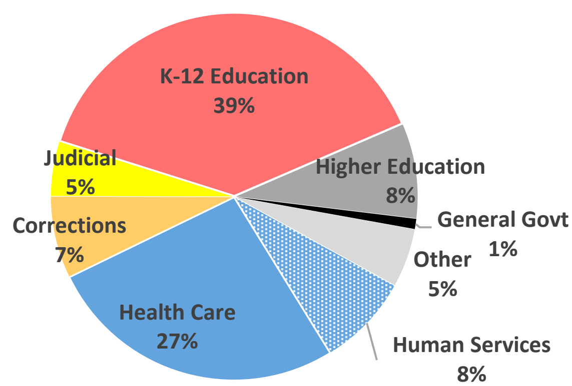


(from Colorado's original constitution)

"The general assembly shall, as soon as practicable, provide for the establishment and maintenance of a thorough and uniform system of free public schools throughout the state, wherein all residents of the state, between the ages of six and twenty-one years, may be educated gratuitously."

Since Colorado's statehood, funding K-12 education has been a partnership effort between both state and local governments through an increasingly complex series of fiscal formulas, state laws and a constitutional spending mandate. At 40% of the state's budget, K-12 education is the largest expenditure out of Colorado's General Fund and consumes 50% of local property tax revenues.

Funding K-12 Education represents about 40% of the State's General Fund Budget



Colorado General Fund budget, FY2017-18

Source: Colorado Legislative Council

Though funding K-12 education is a priority of the State, that funding has been challenged over the last 30 years as a result of three primary factors:

1) An erosion of the local property tax base caused by the interaction of the Gallagher Amendment to our constitution (adopted in 1982) and the TABOR amendment (which was adopted in 1992).

2) An erosion of state revenues relative to the size of the economy as a result of the Taxpayers' Bill of Rights (TABOR) Amendment (1992).
3) Increasing costs for funding K-12 education as a result of the addition of program requirements related to students' special needs, accountability, accreditation, assessments, school safety, and changes to and school curriculum.

History of K-12 Funding in Colorado

As their largest budget expenditure (40% of the state's General Fund budget), funding K-12 education is a partnership effort between local and state governments. While local governments have historically had primary responsibility for funding (and managing) K-12 education, the erosion of the local residential property tax base (caused by the Gallagher Amendment and its unintended interaction with the TABOR Amendment) has inhibited the ability of local governments to fund K-12 and has thus forced the State to assume the majority share of that funding responsibility. And, to the extent that the State has been forced to assume an increasing share of the responsibility for funding K-12 education, the State has correspondingly assumed a larger role in the oversight and management of what has traditionally been an area of primarily LOCAL control.

1867 Statehood Requirement for Public Education

- Colorado's constitution requires the state to provide a public education system that is free thorough and uniform.
- Prior to 1973, K-12 education was primarily funded and controlled locally through the collection of local property taxes and locally-established tax mill levies. Not surprisingly, the wealthier school districts had the best schools and best education and there was significant disparity in the quality of education based on a student's zip code.

1973: Public School Finance Act of 1973

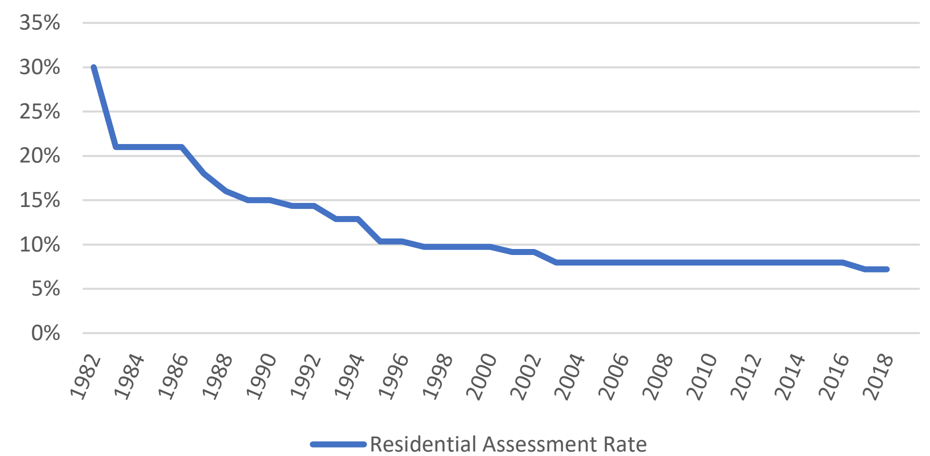
- With the passage of the "Public School Finance Act of 1973", the Colorado legislature took its first cut at adopting a comprehensive modern school finance system which attempted to equalize funding in the school districts across the state regardless of the property wealth in the local school district. By using state funds, the legislature began to raise the per-pupil funding in the least wealthy districts in the state.[1]

1982: Gallagher Amendment

- Colorado voters adopt the "Gallagher" amendment to the state constitution which begins a long-term erosion of the local residential property tax base on which schools depend for local funding. Local governments try to counter this erosion of their property tax base by "floating" their local tax rate (mill levy) upward to sustain a consistent funding stream to support K-12 education. (This ability to "float" local mill levies is later prohibited by the voters' subsequent adoption of the TABOR Amendment in 1992 which challenges K-12 funding.)

[1] "Time for a Divorce", Delay, 2009

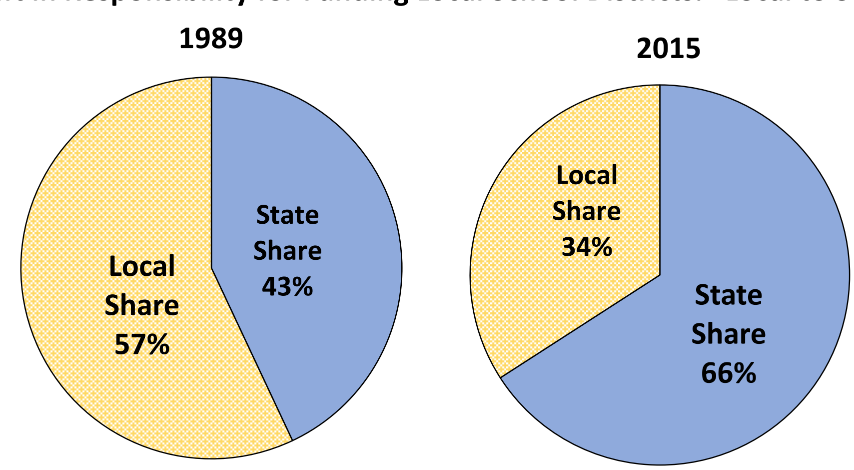
Growth in residential property values, coupled with Gallagher's interaction with the TABOR Amendment, has forced down the Residential Tax Assessment Rate and thus eroded the residential property tax base which provides local funding for K-12.



SOURCE: Colo Legislative Council

- Because of the interaction between the "Gallagher Amendment" (1982) and the TABOR Amendment (1992), the local residential property tax base has been eroded over time. This erosion of the tax base has challenged the ability of local school districts to equitably fund K-12 education locally, thus forcing the burden for funding K-12 education – and the accompanying primary decision authority for administering K-12 education – to gradually shift from LOCAL governments to the STATE government. In 1989, the state was responsible for contributing 43% of total K-12 funding; the state's share had grown to 66% by 2015.

Shift in Responsibility for Funding Local School Districts: Local to State



1988: Public School Finance Act of 1988

- The 1988 Act established two new themes in the school finance debate:
  1. First, the 1988 Act set as one of its goals funding an equitable level of education for every student in the state, regardless of local wealth and costs. That theme of equity, of providing equitable access to education for every student in the state, remains the dominant theme of school finance today.

  2. The 1988 Act also sought to address tax equity issues between school districts by assuming that both the local school district and the state had an important role in funding public education, and it sought to balance funding at 50 percent from each source. In addition, the 1988 Act also sought to standardize the mill levy in all school districts across the state. Every school district was to have the same mill levy, regardless of the property values in the district.

     While the Act sought to standardize the mill levy between districts, it also permitted local school districts to ask their voters to approve "mill levy overrides" to provide additional local funding which is NOT considered as part of the Local Share of the school finance formula (and therefore would not result in a corresponding decrease in state funding) up to 5% of their "total program" funds as calculated by the School Finance Act or $200k, whichever was greater.

1990's: Educational "Standards"

- For the first time, a series of new educational "standards" are developed, both nationally and at the state level, which require additional K-12 investments for specific priorities such as educational proficiency, closing achievement gaps between socio-economic classes, providing assistance to those for whom English is not their primary language, and providing special assistance to those with learning disabilities and academically-gifted students. Congress' adoption of the "No Child Left Behind Act" also begins to insert the federal government into K-12 administration which had previously been under the jurisdiction of local and state governments. (The voters' subsequent adoption of the TABOR Amendment in 1992 challenges the state's ability to adequately fund these new educational standards.)

1992: TABOR Amendment

- Colorado voters adopt the "Taxpayers Bill of Rights" (TABOR) amendment to the state constitution which limits funding for state and local governments (of which K-12 is the largest component at 40% of the state budget) and prohibits state and local government from sustaining consistent funding streams to support K-12 without ongoing voter approval. The interaction between TABOR and Gallagher created new disparity in local mill levy rates – perversely keeping mill levies high in poorer districts which have little economic growth and forcing them lower in wealthier districts which enjoy strong economies – and also began a continual shift in the K-12 funding responsibility from local governments to the state government.

1994: School Finance Act of 1994

- Because of the adverse impact which the TABOR Amendment and its interaction with the Gallagher Amendment was having on school funding, and because the legislature never fully funded the 1988 School Finance Act, the legislature made another attempt to address K-12 funding in the “School Finance Act of 1994”. Under the 1994 Act, every school district received the same base per-pupil amount that was then to be adjusted for additional costs resulting from district size, cost of living, personnel costs and at-risk students.

- While TABOR requires that voters approve any tax increase, the 1994 School Finance Act didn’t permit school districts to request such an increase to sustain current funding. Rather, the 1994 Act also increased from 5% to 10% the allowable amount of additional funding which local school districts were permitted to ask their voters to approve through “mill levy overrides” to provide additional local funding which is NOT considered as part of the Local Share of the school finance formula. This allowable cap on mill levy override revenues has subsequently been increased to the point that, beginning in FY 2009-10, a district’s override revenues cannot exceed 25% of its Total Program funding (or 30% for rural districts) or $200,000, whichever is greater. Because wealthier school districts have had more success than poorer districts in securing local voter approval for such mill levy overrides, this increasing allowance to utilize overrides has resulted in increasing the funding disparity between school districts.

2000: Amendment 23

- In response to TABOR’s erosion of the state’s revenue base and increasing K-12 costs, Colorado voters adopt “Amendment 23” to Article IX, Section 17 of the state constitution which required the state to fund K-12 at a minimum amount every year, regardless of economic conditions.

  Amendment 23 did three things:

  1. **<u>Mandated INCREASED funding for K-12 for 10 years</u>**
     By increasing funding by 1% per year for ten years, Amendment 23 proposed to return funding for K-12 to the level it was in 1988 when Colorado’s per-pupil investment was roughly equal to the national average.

  2. **<u>Mandated MINIMUM FUNDING for K-12 based on Student Enrollment and Inflation</u>**
     Amendment 23, as originally interpreted, required that the state annually increase both “BASE funding” and “FACTOR funding” by the rate of inflation PLUS student population, and increase “Categorical funding” by the rate of inflation, alone.

     a. “BASE funding” represents the minimum amount of funding required to educate a student with no special needs. The “base” represents costs for such things as salaries for teachers and administrators, staff development, technology, software, and class materials. Prior to the State’s reinterpretation of Amendment 23 in 2010, “base funding” also included additional “factor funding” to compensate for disparity between schools caused by their unique percentage of “At Risk” students, their Cost-of-Living, and their District Size.

     b. “FACTOR funding” provides additional funding to address disparities between school districts based on:

        i. the Cost-of-Living for their community
           Schools whose employees live in areas with a higher cost of living are eligible for additional funding.

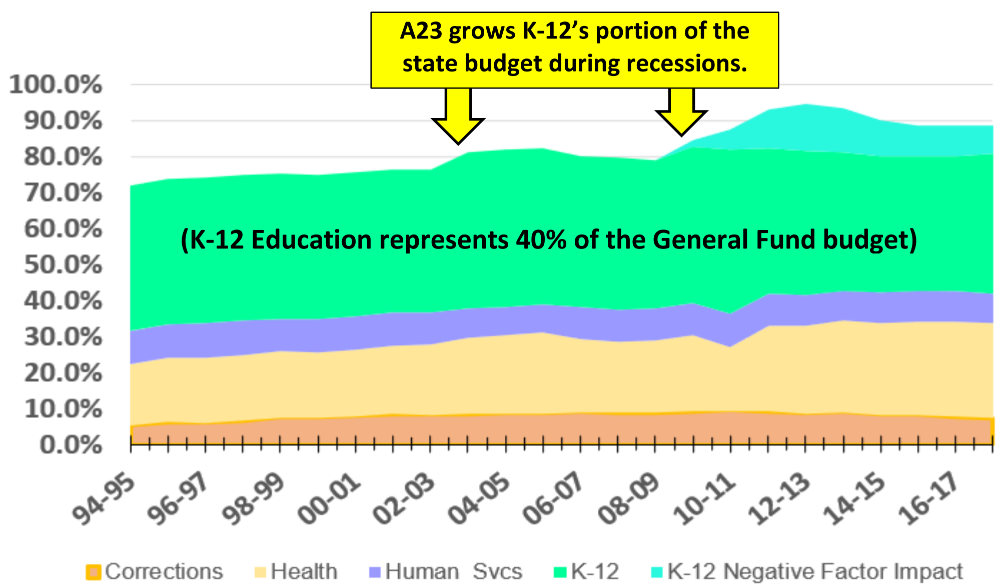
ii. size of the School District
Smaller school districts which cannot realize the same economies of scale as larger school districts are eligible for additional funding.

iii. number of "At-Risk" students
Schools with a higher number of students who qualify for free lunch based on federal guidelines are eligible to receive additional funding to deal with these higher per-pupil costs.

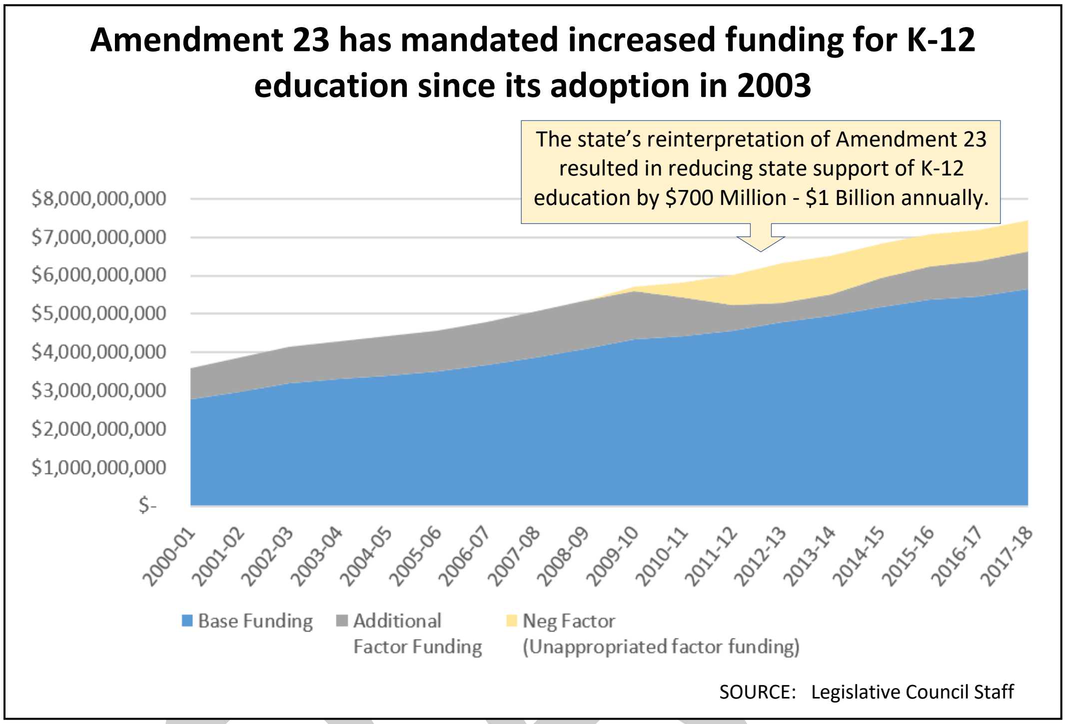
c. "Categorical funding" is calculated outside of the state's School Finance Act and is intended to provide additional support for unique student needs in the areas of Special Education, English Language Learners, Gifted & Talented, Career and Technical education, Transportation needs, and Small Attendance Centers. Because Amendment 23 requires that Categorical funding grow at only the annual rate of inflation and NOT student enrollment, and since this formula was put in place in 1994 and has never been updated, it doesn't account for the cost of the additional 300,000 students which have been added to the K-12 population since then.

Because the Amendment 23 funding requirement for K-12 applies regardless of the state's economic condition, K-12's share of the state's budget has increased during times of economic recessions in 2002 and 2008 as the state has had to reduce discretionary funding for other program areas. The state relies heavily on its General Fund (the state's checking account) to pay for Amendment 23's funding mandate to the point today that K-12 education constitutes the largest expenditure out of the General Fund at about 40%. In addition to General Funds, the state utilizes funds from the State Education Fund (which receives about 7% of the state's income tax revenue as required by Amendment 23).

Amendment 23's recession-proof funding mandate forces K-12 to consume an increasingly larger proportion of the state's General Fund during recessions.



As a result of reduced state revenues caused by the Great Recession of 2008-10, the state reinterpreted Amendment 23 starting in 2010 so that "Factor" funding was no longer considered to be part of the Amendment 23 constitutional funding requirement.



3. **Created the State Education Fund (SEF)**
In creating the SEF, Amendment 23 diverts an amount equal to one-third of one percent of taxable income to the fund, or about 7.2% of the total revenue which the state collects through its income tax. Money in the SEF may be used to meet the minimum K-12 funding requirements which Amendment 23 also established. In addition, the General Assembly may appropriate money from the SEF for a variety of other education-related purposes as specified in the state constitution.[2]

While Amendment 23 provided for more state funding for K-12 education, it did nothing to address the adverse effects of TABOR and Gallagher on local tax bases, nor did it attempt to address the increasing disparity in local mill levys.

2007: Mill Levy Stabilization Act

- The Mill Levy Stabilization Act was intended to stabilize school district mill levies and slow the erosion of local property tax revenues by capping local district mill levies at no more than 27 mills and freezing mill levies for districts with mill levies of 27 mills or less, thus protecting those districts from TABOR's requirement that they lower their mill levy if increasing property values result in additional revenues. The mill levy cap/freeze applies to the 174 out of 178 school

[2] Colorado Legislative Council, "Report on the State Education Fund", 2/1/18 (https://leg.colorado.gov/sites/default/files/report18-final.pdf)

districts whose voters have de-Bruced local school district revenues and received approval from their local voters to keep additional revenues beyond their spending cap.

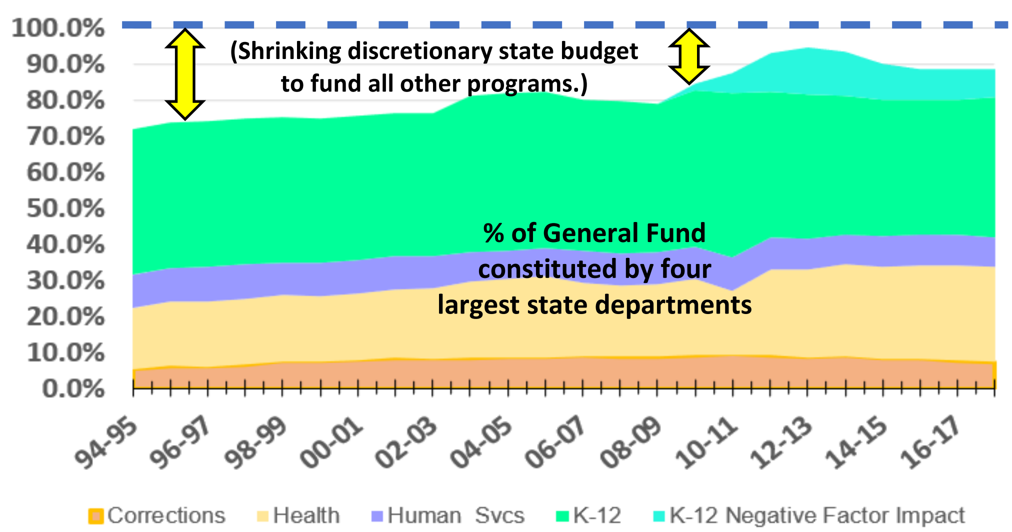
2008: Building Excellent Schools Today (BEST)

- The legislature created the BEST competitive grant program to provide school districts with matching funds for the construction of new schools as well as general construction and renovation of existing school facilities. BEST is funded through multiple revenue sources, including State Land Board proceeds, marijuana excise tax, Colorado Lottery spillover funds, and interest accrued in the Public School Capital Construction Assistance Fund. BEST grants have totaled about $100 million/year and a match from local school districts. (To put this amount in context, the state estimated in 2008 that the identified need for school construction amounted to somewhere between $13.9 billion and $18 billion.)

2010: Negative Factor (a.k.a. Budget Stabilization Factor)

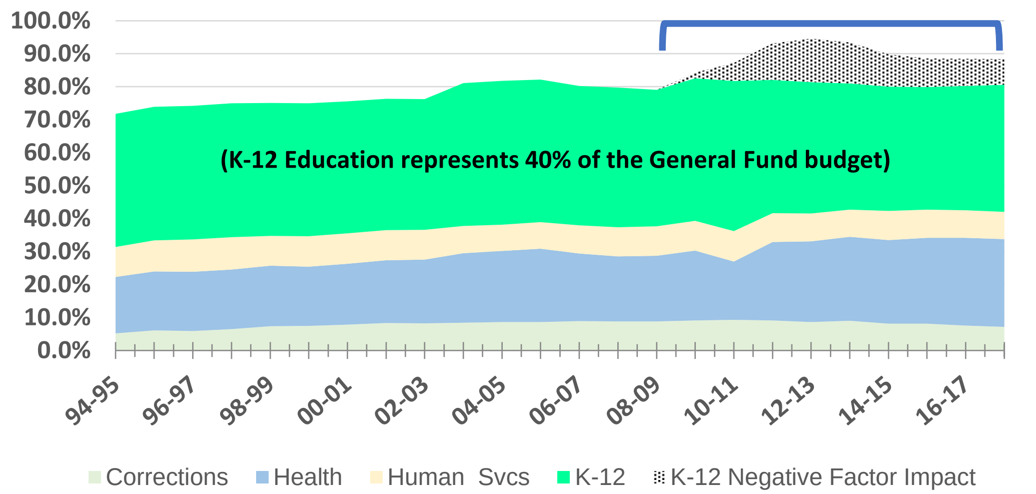
- With the drop in state revenue as a result of the "Great Recession" of 2008-2010, and Amendment 23's requirement that state funding for K-12 continue to grow at the rate of student enrollment plus inflation, the legislature was faced with the prospect of drastically cutting other program like Higher Education to comply with Amendment 23's funding mandate.

During the Great Recession of 2008-10, the State was faced with the prospect of drastically cutting other programs in order to comply with Amendment 23's funding mandate for K-12.



- In order to preserve funding for other programs, the state chose to reinterpret Amendment 23's funding mandate to EXCLUDE the additional "factor" funding which addressed school disparity (district's size, cost of living, personnel costs and at-risk students). This has since resulted in a reduction in annual K-12 funding by about $700-900 million annually which has allowed the state to continue to support other priorities such as Higher Education.

In order to free-up funding to sustain other programs, the State reinterpreted Amendment 23 in 2010 which has reduced State support for K-12 education by $700 million to $1 Billion annually.



By reinterpreting Amendment 23 and eliminating "Factor" funding from the K-12 constitutional funding mandate, the state essentially converted approximately $1.5 billion in previously MANDATED K-12 funding to now be DISCRETIONARY. Since 2010, the state has opted to contribute about $600-800 million annually in discretionary funding to K-12 to partially offset the $1.5 billion cut in previously mandated support.

Because the state applies the Negative Factor as an across-the-board percentage cut applied equally to all school districts, the smaller rural school districts are most adversely impacted because they don't have the economies of scale to mitigate that impact.

While the Negative Factor has effectively nullified Amendment 23's funding mandate for the time being, and subsequently stemmed the growth of K-12's share of the state General Fund budget, it is likely that Amendment 23's funding mandate may be realized again at some point in the future if the state endures an economic downturn similar to 2008 and is forced to exhaust all of its remaining discretionary funding for K-12.

2012: Marijuana Tax Revenues

- With the voters' adoption of the use of RECREATIONAL marijuana, K-12 education receives a portion of recreational (a.k.a. retail) marijuana tax revenues in three forms:
    - The first $40 million of the 15% Excise Tax on recreational marijuana is dedicated to the state's "Better Schools Today" (BEST) program to help pay for school construction costs.

Although recreational marijuana sales haven't yet generated enough revenue to fully satisfy this funding requirement, the $40 million benefit would represent approximately 3% of the total estimated $13.5 billion in K-12 construction needs as currently estimated by the Colorado Department of Education[3].

- Any remaining amount of the 15% Excise Tax on recreational marijuana BEYOND the first $40 million (which is dedicated to help pay for school construction) is dedicated to the K-12 "Public School Fund" which can support either school construction or the state's K-12 funding obligation as defined in the School Finance Act. (As of 2019, there have not yet been enough recreational marijuana sales to trigger this threshold payment.)
- 12.59% of the State's 90% share of the 15% Sales Tax on recreational marijuana is dedicated to the K-12 "Public School Fund". This amounted to about $30 million in 2017-18.

How K-12 is funded today

Funding for K-12 education is defined in four different categories:

1. Total Program Funding
2. Categorical Funding
3. Federal Funding
4. Other Funding

1. **Total Program Funding**

   Total Program Funding is a formula defined in the State's "School Finance Act" and includes three basic parts:

   a. BASE funding
   - Colorado's K-12 funding requirement begins with a "base" amount which represents the minimum amount of funding required to educate a student with no special needs. The "base" represents costs for such things as salaries for teachers and administrators, staff development, technology, software, and class materials.
   - Because of the adoption of Amendment 23 to the state constitution in 2000, the state is required to annually grow "Base" funding for K-12 education at the rate of student enrollment plus inflation.

   b. FACTOR funding
   - Recognizing that different school districts have different characteristics which require different funding needs, the School Finance Act provides for additional funding for school districts based on:
     i. the Cost-of-Living for their community
        Schools whose employees live in areas with a higher cost of living are eligible for additional funding.
     ii. size of the School District
        Smaller school districts which cannot realize the same economies of scale as larger school districts are eligible for additional funding.

[3] Colorado Department of Education website, https://www.cde.state.co.us/cdefinance/capconstbest

iii. number of “At-Risk” students
Schools with a higher number of students who qualify for free lunch based on federal guidelines are eligible to receive additional funding to deal with these higher per-pupil costs.

- Although the constitutional K-12 funding requirement of Amendment 23 was originally interpreted to ALSO require the state to annually grow “Factor” funding at the rate of student enrollment plus population, the state reinterpreted Amendment 23 starting in 2010 so that “Factor” funding is no longer part of the Amendment 23 constitutional requirement.

c. NEGATIVE FACTOR (a.k.a. Budget Stabilization Factor)

- As a result of the state’s decision in 2010 to reinterpret Amendment 23’s funding requirement for K-12 education, the state is no longer required to annually grow “Factor” funding. Starting in 2010, this meant that the $1.5 billion in annual “Factor” funding which the state was previously REQUIRED to fund was now DISCRETIONARY for the state to fund, and the state has since chosen to provide K-12 education with $600-$800 million in annual “Factor” funding since 2010. The amount of “Factor” funding which the state chooses NOT to fund each year has been referred to as the “Negative Factor” or the “Budget Stabilization Factor” and that amount is subtracted from the “Factor funding” calculation described above.

2. **Categorical Funding**
Categorical funding is calculated outside of the state’s School Finance Act and is intended to provide additional support for unique student needs in the areas of Special Education, English Language Learners, Gifted & Talented, Career and Technical education, Transportation needs, and Small Attendance Centers.
    - Categorical funding constitutes a relatively small amount of total K-12 funding needs ($250 million) and, per Amendment 23, is required to grow at the annual rate of inflation. (It’s worth noting that Categorical funding is NOT required to also grow at the rate of student enrollment and, since this formula was put in place in 1994 and has never been updated, it doesn’t account for the cost of the additional 300,000 students which have been added to the K-12 population since then.)

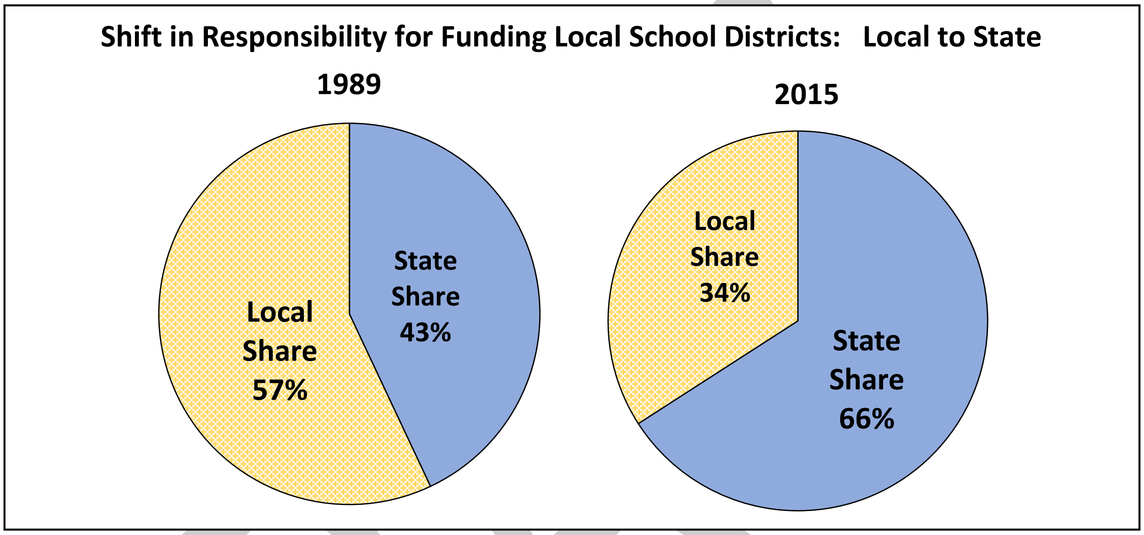
3. **Federal Funding**
Additional Federal Funds are allocated to school districts to partially fund certain federally-required programs or serve specific students (i.e. special education and English language learners).

4. **Other Funding**
In addition to the aforementioned sources of funding from Local government (local property and use taxes) and State government (School Finance Act), local School Districts receive varying amounts of funding through these other revenue streams:
    1. Local Mill Levy Override funds approved by local voters to support local education programs and priorities. These dollars are in addition to the traditional mill levy which the “Local Share” portion of the School Finance Act calculation.
    2. Grants: Typically for a specific purpose and for a particular length of time.
    3. Bond Dollars: Additional funding approved by local voters to pay for capital construction. Bond dollars cannot be used for general operations (i.e. salaries or supplies) in a School District.

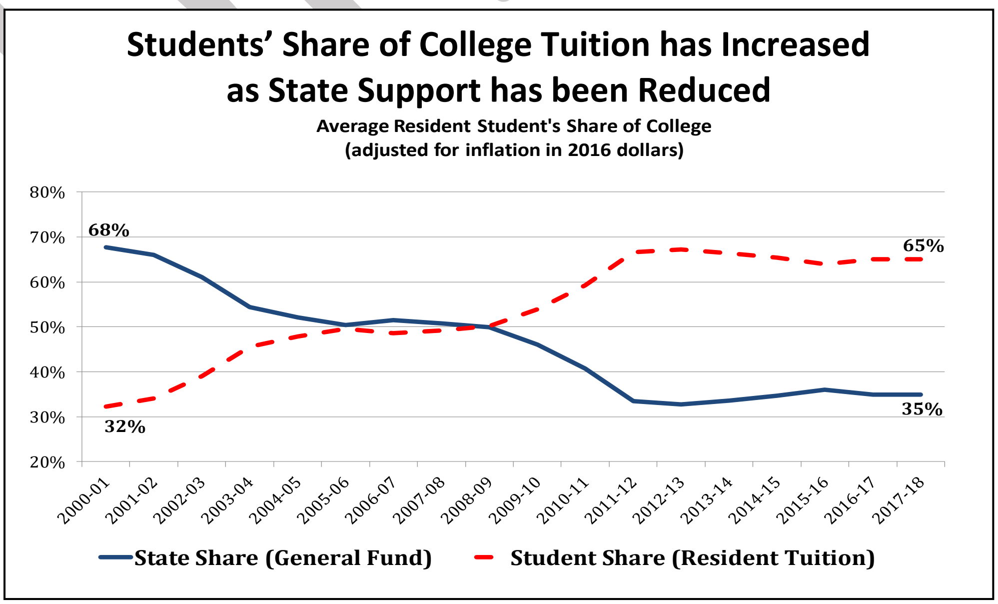
How K-12 Education Funding has Changed Over Time

Since 1973, as the State has sought to equalize the K-12 education experience to appropriately provide an equal opportunity for all students, and as Coloradans have voted to limit the flexibility of state fiscal policy to support such efforts through the adoption of the Gallagher Amendment (1982) and TABOR Amendment (1992), while mandating funding for K-12 via Amendment 23, two concerning trends in education funding have developed:

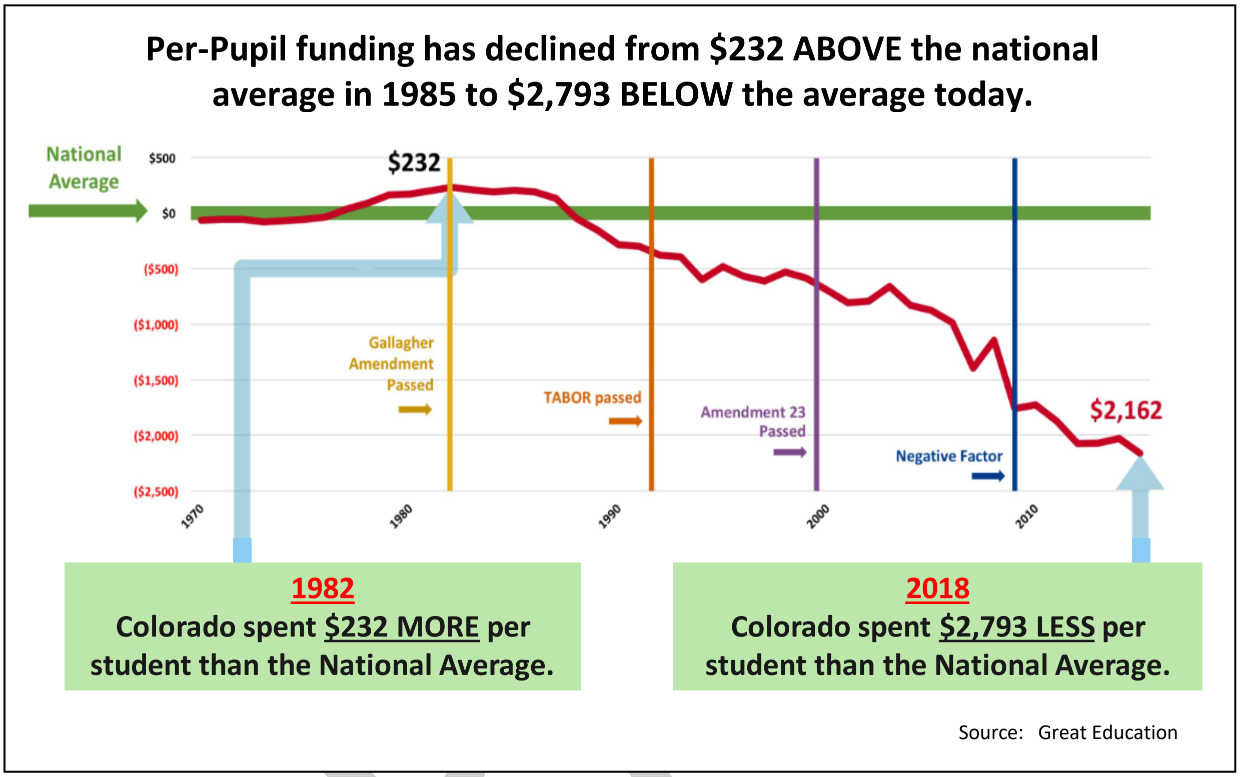
1) **The State has had to assume a larger share of the responsibility for funding K-12 education, from 43% in 1989 to 66% in 2015.**



This increased responsibility on the state has contributed to forcing the state to reduce funding for other programs such as Higher Education, in which the state has reduced its support by 50% since 2000.



2) **Funding per pupil in Colorado has continued to drop relative to the national average, from $232 ABOVE the national average in 1985 to almost $2,800 BELOW the national average in 2018.**



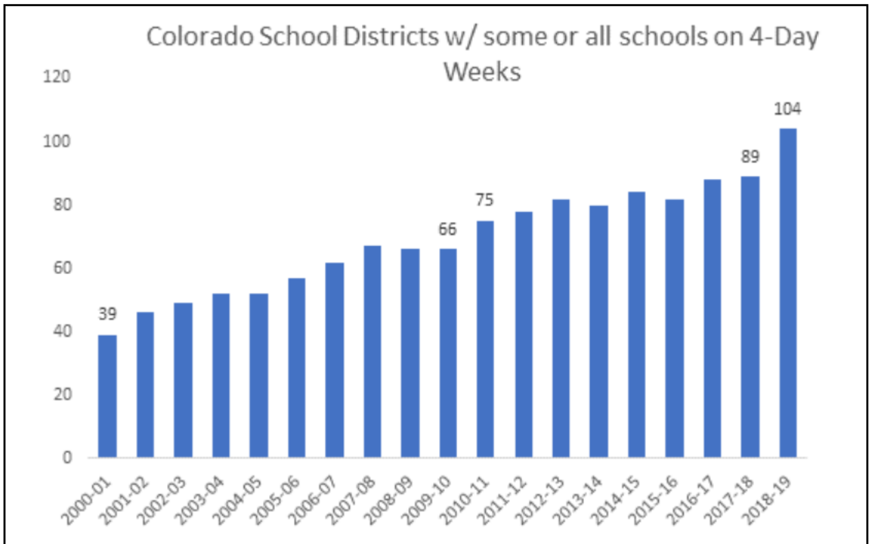
It is worth noting that, even though the adoption of Amendment 23 in 2000 helped to ensure increased funding for K-12 at the rate of student enrollment plus inflation, Colorado has still continued to fall behind the national average in per-pupil funding for two reasons:

1. The costs associated with K-12 education have grown at a rate faster than inflation because of additional costs related to such things as school security, mandated testing, and mandated programs for students with special needs, and because many of the typical costs related to K-12 education – such as health insurance for teachers, pensions and energy costs – grow at a rate faster than inflation.
2. Most other states have continued to invest more in their K-12 programs to pay for the additional costs of K-12 education, thus leaving Colorado further behind.

Inadequate funding of K-12 education has adversely impacted performance

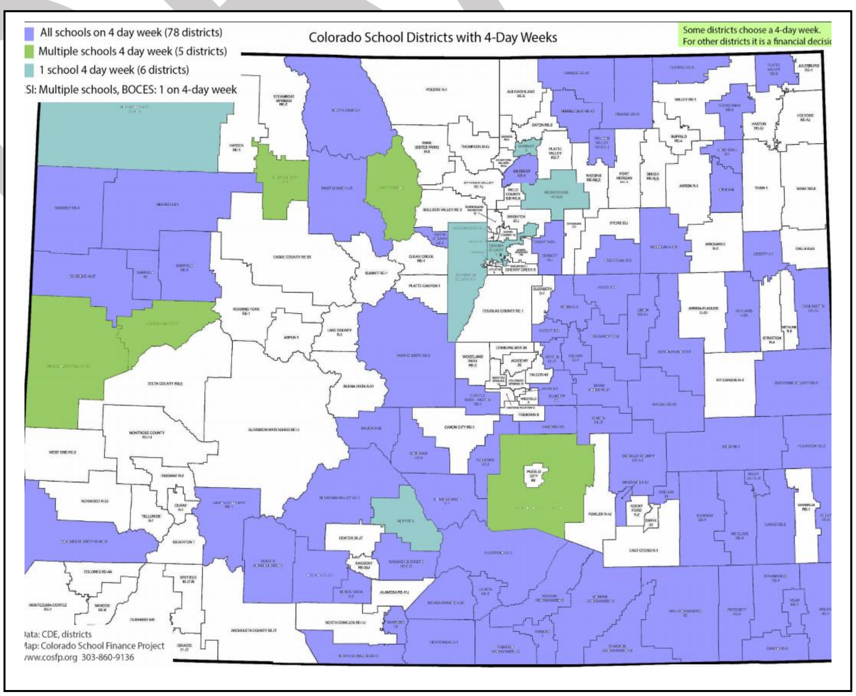
While funding is only one factor that contributes to the performance of K-12 education, it is an important factor, and there is growing evidence that inadequate funding is adversely impacting K-12 performance in several ways.

1. **The growth in the number of school districts which have opted to move from a 5-day school week to a 4-day school week has almost tripled since 2000.**
   In 2000, 39 of Colorado's 178 school districts had some or all of their schools on a 4-day school week; many of these were intentionally designed to utilize a 4-day week as part of their modified curriculum.   By 2018, the number of school districts utilizing a 4-day school week had grown to 104, primarily as a result of their inability to fund a full 5-day week.

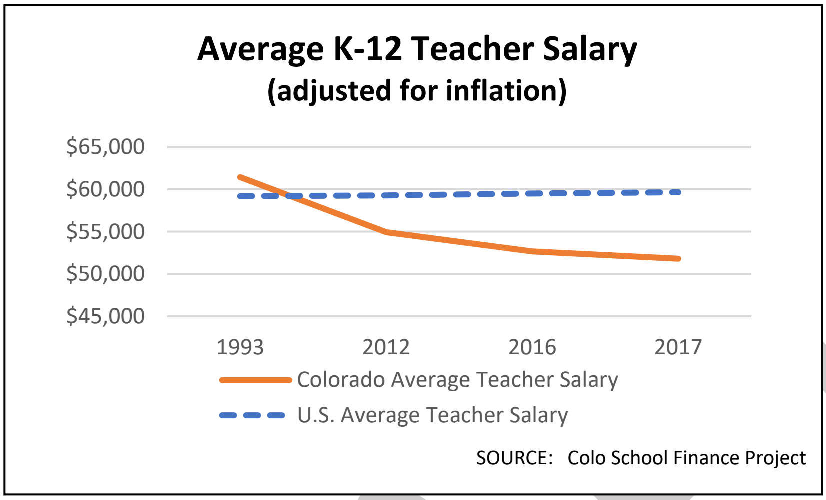


SOURCE: Colorado School Finance Project

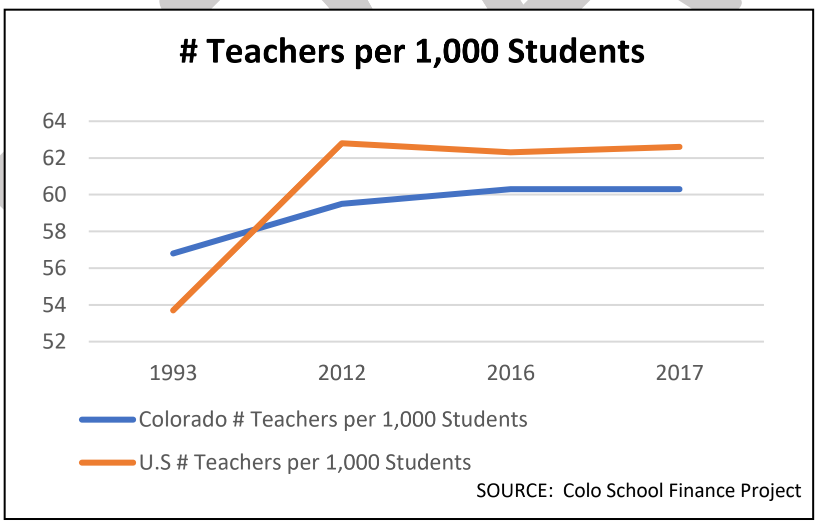
While it's been primarily rural school districts which have been forced to use 4-day school weeks because of funding deficiencies, the Brighton school district in the Denver metro area was also forced to make this transition in 2018.



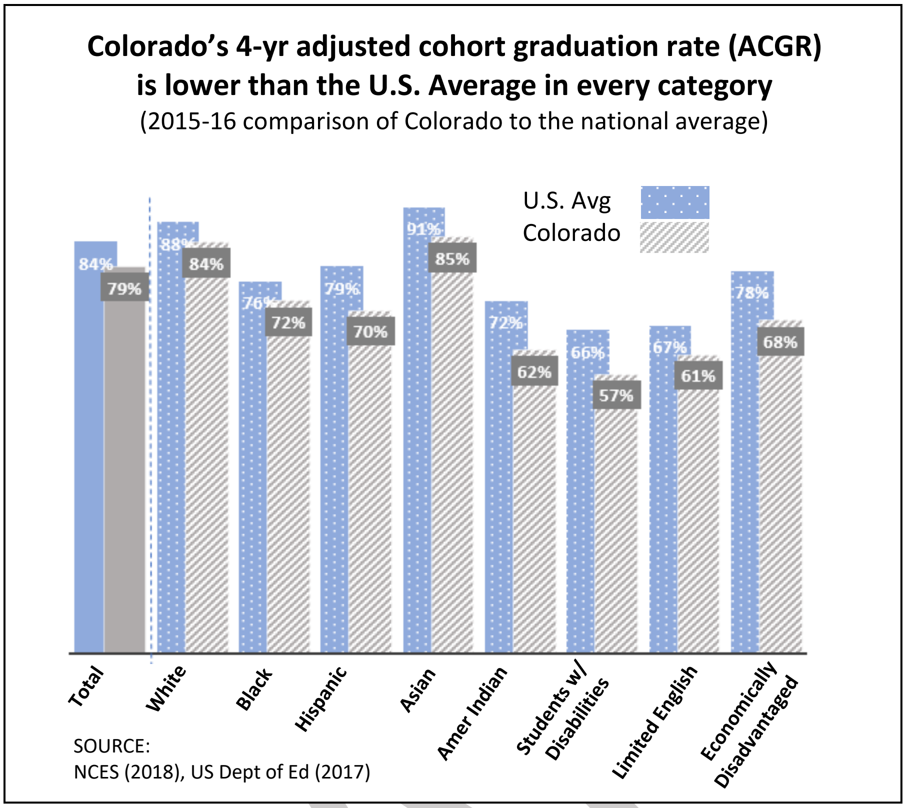
2. **Colorado ranks 50th in teacher wage competitiveness.**
   This statistic from Rutgers Education Law Center compares teachers to non-teachers with similar education, experience and hours worked. Colorado is 2nd in number of novice teachers (1st or 2nd year) in the classroom (Source: Education Week, October 2016).



3. **Colorado's teacher-to-student ratio lags the national average.**



4. **Colorado's graduation rate lags the national average in EVERY student subgroup.**



5. **Rural school districts are most adversely impacted.**
   Tragically, the poorest school districts in Colorado's rural areas are most adversely impacted by the state's K-12 funding challenge because:
   a. Rural areas don't have the economies of scale to mitigate the impact of the funding reduction posed by the state's Negative Factor which is applied equally to all school districts as an across-the-board percentage cut.
   b. The Gallagher Amendment's erosion of the local residential property tax base most adversely impacts those areas of the state with the slowest growth in residential property values, which is primarily in the rural areas.

SUMMARY

Although Colorado has both a legal and strategic obligation to adequately fund K-12 Education, the Gallagher Amendment's erosion of the local residential property tax base, coupled with the TABOR Amendment's formulaic shrinkage of the state General Fund budget relative to the growth of the economy, coupled with increased expectations of K-12 without commensurate funding to pay for those mandates, has placed Colorado below the national average in every K-12 performance metric.

Although the Amendment 23 funding mandate was intended to correct funding deficiencies for K-12 Education and ensure equitable access to a quality education for all students, unfunded mandates on K-12 since then, coupled with the state's reinterpretation of Amendment 23's minimum funding requirement, have forced Colorado to continue to trend significantly below the national average in Per Pupil funding and created increasing inequities between school districts as those which are able seek additional funding from their local voters, and those which cannot secure such funding fall further behind.