SUBJECT: Public and higher education fiscal matters, including school finance

COMMITTEE: Public Education — committee substitute recommended

VOTE: 6 ayes — Eissler, Aycock, Huberty, Shelton, T. Smith, Weber

4 nays — Hochberg, Allen, Guillen, Strama

1 present, not voting — Dutton

SENATE VOTE: On final passage, May 20 — 19-11 (Davis, Deuell, Ellis, Gallegos, Lucio, Rodriguez, Uresti, Van de Putte, Watson, Whitmire, Zaffirini)

WITNESSES: No public hearing

BACKGROUND: **Permanent Health Fund.** Education Code, ch. 63 governs permanent funds for health-related higher education institutions. The 76th Legislature in 1999 established the Permanent Health Fund with interest earnings from the tobacco settlement relating to a lawsuit filed against the tobacco industry. The University of Texas System board of regents administers the fund. Amounts available for distribution from the fund may be appropriated only for programs that benefit medical research, health education, or treatment programs. According to the Legislative Budget Board, $74.9 million was appropriated from the fund to the health-related institutions for fiscal 2010-11.

Public school finance. The state's statutory financial obligation to school districts is determined by the sum of the amounts to which each district is entitled. The LBB has estimated the state's financial obligation to be $42.6 billion, which takes into account increased student enrollment and decreased local property tax revenue. Because the school finance system is set by statute, the Legislature would have to amend the Education Code to permit a state appropriation to the Foundation School Program below the statutory financial obligation.

Public school districts receive state funding based either on their target revenue hold-harmless amount— the district's 2009-2010 funding— or the public school finance formula, whichever is higher. Formula funding is distributed using weights and adjustments based on student and district characteristics to account for the varying costs of educating different types of students

The 79th Legislature in 2006 enacted HB 1 in its third called session, in response to the Texas Supreme Court's holding that school districts lacked "meaningful discretion" in setting local school property tax rates, effectively resulting in an unconstitutional state property tax. At the time, most local governments were taxing at or near the state property tax rate cap of $1.50. In HB 1, the Legislature compressed local property-tax rates to $1.00. The target revenue hold-harmless mechanism was included in HB 1to ensure school districts did not lose funding by guaranteeing they would receive, at minimum, their 2005-06 funding. The 81st Legislature in 2009 enacted HB 3646 to determine target revenue amounts on a school district's 2009-2010 funding. About 76 percent of school districts receive their target revenue hold-harmless amount.

DIGEST:

CSSB 1581 would amend portions of various codes as required to implement provisions for public and higher education in the general appropriations act for fiscal 2012-13.

Article 1: Higher education administration. The bill would amend various sections of the Education, Government, Natural Resources, Tax, Insurance, Labor, Property, and Health and Safety Codes, and the Texas Civil Statutes involving financial management, administrative, and reporting requirements by public institutions of higher education.

Art. 1 would amend provisions relating to financial management; acquisition of goods and services and the qualifications of certain businesses to enter into contracts with institutions; human resources; the membership of certain boards; real estate and construction; and the confidentiality of certain information. It would allow about 20 reports to expire as of September 1, 2013, unless affirmatively continued. It also would repeal more than 30 reporting requirements in the Education, Government, and Labor Codes and the Texas Civil Statutes. Eleven of the repealed sections would become effective September 1, 2011, and 18 would become effective September 1, 2013.

Article 1 would take immediate effect if the bill were finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2011.

Article 2. Advanced placement. The bill would amend the eligibility criteria for awarding advanced placement (AP) exam fee subsidies to students. Eligible students would have to demonstrate financial need, not just academic merit.

Article 3. Early High School Graduation Scholarship Program. A student could not receive an award through the Early High School Graduation Scholarship Program if the student graduated from high school on or after September 1, 2011. The bill would remove the requirement that savings to the public school finance system from the program be used to provide exemptions from higher education tuition for certain students. The bill would require the education commissioner to transfer gifts, grants, and donations accepted by the Texas Education Agency (TEA) to the Texas Higher Education Coordinating Board to distribute to higher education institutions to provide tuition exemptions.

Article 4. Tuition exemptions. The bill would limit eligibility for educational aide tuition exemptions to persons seeking certification in one or more subject areas determined by TEA to be experiencing a critical shortage of teachers.

This provision would apply beginning with tuition and fees charged for the 2011 fall semester.

Article 5. Partial liquidation of permanent health fund. The bill would authorize the partial liquidation of the Permanent Health Fund managed by the University of Texas System. The board of regents would be required to transfer to each health-related institution entitled to receive distributions from the fund a one-time liquidation distribution for the state fiscal year ending August 31, 2012, and for that fiscal year and each subsequent fiscal year, a reduced annual distribution as set forth by the bill.

By November 1, 2011, the board of regents would have to calculate the amount of each liquidation distribution and provide written notice to all institutions entitled to receive distributions from the Permanent Health Fund. The notice would have to specify the amount of the liquidation distribution to be made in fiscal 2012 and the amounts of the other distributions to be made in that fiscal year to each institution from the per capita account and the formula account.

As soon as practicable after the beginning of fiscal 2012, the Permanent Health Fund would be segregated into two accounts: the per capita account (70 percent of the fund) and the formula account (30 percent of the fund).

The partial liquidation distribution would be equal to one-third of the institution's fractional share of the value of the per capita account. An institution's fractional share of the per capita account would be determined by multiplying the amount segregated into the per capita account by a fraction, the numerator of which would be one and the denominator of which would be the number of institutions that were entitled to receive a permanent fund distribution.

In fiscal 2012, and in each subsequent fiscal year, the annual appropriation for the distribution from the investment of the per capita account would be distributed in equal shares to each institution. This would not apply to the amounts distributed as liquidation distributions in fiscal 2012.

In every fiscal year in which distributions were made from the per capita account, the amount appropriated for distribution from the investment of the formula account would have to be distributed in equal portions with respect to certain categories. Each institution would receive a share in each category proportionate to the amount that the institution spent in that category in the preceding fiscal biennium, compared to the total spending of all the other institutions. The categories would be:

- instructional expenditures;
- research expenditures; and
- unsponsored charity care.

Amounts appropriated for distribution from the investments of the per capita account and the formula account would be distributed quarterly by the comptroller to each health-related institution. Baylor College of Medicine would be eligible to receive amounts appropriated for distribution from the investment of the formula account. The comptroller, in consultation with the University of Texas System board of regents, would be required to establish procedures to implement these provisions. A liquidation distribution would have to be made in accordance with those procedures and in consultation with the institutions.

Any direct costs associated with liquidation distributions would have to be deducted in equal portions from the amounts of the liquidation distributions. The implementation procedures would have to provide for the minimization of any costs associated with making the liquidation distributions considering the liquidity of the investment assets of the fund.

The amount distributed to an institution would be under the exclusive control of the governing board of the institution and could be used by the institution in any manner for any lawful purpose. The comptroller would have to establish procedures to ensure that a liquidation distribution to Baylor College of Medicine was used for public purposes.

Article 6. Dual credit course funding. The bill would prohibit physical education courses from counting toward the contact hours attributable to dual credit funding for a junior college's proportionate share of state appropriations.

This provision would apply beginning with funding for the 2011 fall semester.

Articles 7 and 8. Public school finance The bill would reduce incrementally the amount of additional state aid for tax relief (target revenue hold-harmless) paid to school districts and open-enrollment charter schools, eliminating the funding in 2016.

If a school district were to adopt a maintenance and operations (M&O) tax rate below the rate equal to the state compression percentage multiplied by the district's 2005 M&O tax rate, then the commissioner would reduce the district's entitlement to additional state aid for tax relief by the difference. The provision would apply beginning with M&O tax rates adopted for the 2009 tax year.

Basic and regular program allotments. The bill would amend the basic allotment calculations and instate the regular program allotment beginning September 1, 2011. A school district would be entitled to the regular program allotment (RPA), which would be calculated by multiplying the number of students in average daily attendance (ADA), the district's adjusted basic allotment (AA), and the regular program allotment factor (RPAF), which would be 1.00 or an amount established by appropriation. The RPAF would be 0.98 for the 2011-12 and 2012-13 school years only.

RPA = ADA x AA x RPAF

On September 1, 2015, the basic allotment would increase from $4,765 to $4,900 and on September 1, 2016 would increase to $5,000.

Charter schools. Beginning on September 1, 2011, to determine the funding for an open-enrollment charter school, the commissioner would apply the regular program adjustment factor to calculate the regular program allotment to which the charter school was entitled. Beginning September 1, 2016, charter schools would be entitled to the amount of funding per weighted student in average daily attendance (WADA), excluding enrichment funding, to which the charter would be entitled under the school finance formulas if the school were a school district without tier one local share.

Additional state aid for tax relief. CSSB 1581 would eliminate additional state aid for tax relief (ASATR), i.e. target revenue hold harmless funding, on September 1, 2016. At that point, if the state compression percentage were not established by appropriation for a school year, the commissioner would determine the percentage for each school year.

The bill would reduce the amount of ASATR funding to which a school district and charter school were entitled by providing that they receive a percentage — 93.50 for the 2011-12 school year and 92.35 percent for each subsequent school year — of the current hold harmless amount.

Legislative intent. The bill would codify legislative intent to continue to reduce the amount of ASATR funding to which a school district was entitled and to increase the basic allotment to which a school was entitled between fiscal 2014 and fiscal 2017.

Additional state aid for tax increment financing payments. The bill would ensure that school districts required to pay taxes into a tax increment fund for a reinvestment zone (which has the purpose of making that land more attractive to economic development) received additional state aid to meet their obligations.

Minimum salary schedule. Beginning September 1, 2011, CSSB 1581 would reduce the minimum salary schedule and would change the calculation of the monthly minimum salary for each classroom teacher, full-time librarian, full-time counselor, and full-time nurse. The salary factor that represents years of experience in the monthly minimum salary formula would be decreased under the bill. Each employee would receive the amount determined by the monthly minimum salary formula or the specified monthly amount listed on the minimum salary schedule that corresponded to an employee's years of service, whichever was greater.

The bill would repeal temporarily the requirement that if the minimum monthly salary for a particular level of experience were less than the preceding year, the minimum monthly salary would be the minimum salary for the previous year. On September 1, 2016, the requirement would be reinstated.

The commissioner would be required to submit a report evaluating and providing written recommendations regarding the salary schedule to the governor, the lieutenant governor, the speaker, and the appropriate legislative standing committees, by January 1, 2013.

Interest and sinking tax rates. The bill would provide that if the interest and sinking tax rate calculated decreased after the publication of the meeting notice required by law, the president of the board of trustees would not be required to publish another notice or call another meeting to discuss and adopt the budget and the proposed lower tax rate. The change in law would apply beginning with adoption of a tax rate for the 2011 tax year.

Proration. The bill would change the method by which the commissioner prorated Foundation School Program payments to school districts should the amount appropriated to the FSP for the second year of a fiscal biennium be less than that to which the school district was entitled for that year. The bill would require the commissioner to adjust the total amount for each district by the same percentage to achieve the necessary overall adjustment. A district's recapture payments would be reduced by an amount equal to the adjustment made.

Department of Defense school districts. The bill would authorize the commissioner to ensure that U.S. Department of Defense school districts did not experience more than an 8 percent reduction should the federal government reduce appropriations.

Prekindergarten program requirements. Prekindergarten programs would have to incorporate school readiness skills that were aligned with the Texas Prekindergarten Guidelines approved by the commissioner. A school district's prekindergarten program would have to demonstrate effectiveness in preparing children for kindergarten according to a school readiness certification system established by the commissioner. The commissioner could waive participation in the certification system for school districts whose programs demonstrated effectiveness in preparing students for kindergarten.

The commissioner of human services no longer would be required to consult on the education commissioner's evaluation of prekindergarten programs. The bill would remove the requirement that programs be evaluated based on the recommendations contained in the report to the 71st Legislature.

The commissioner or an entity acting under contract with the commissioner would provide technical assistance to implement proven school readiness components to a school district operating a prekindergarten program that was not certified by the commissioner for two consecutive review cycles. The commissioner would not be required to provide assistance if funding were not available.

The commissioner could adopt rules to implement the school readiness skills guidelines, the certification program, and the criteria to evaluate prekindergarten programs.

For the 2012-13 school year, until September 1, 2013, the commissioner could withhold funds appropriated to a school district for prekindergarten students enrolled in a classroom, participating in the certification system, to pay the costs of the district's participation. The commissioner also could withhold a portion of the school district's Foundation School Program payments to ensure that each school district was paying a comparable amount for the costs of the certification system.

Unless otherwise stated, the provisions would apply beginning with the 2011-2012 school year.

Effective Date. Unless otherwise stated, the bill would take effect September 1, 2011.

SUPPORTERS SAY:

Article 2. Advanced placement. The state should not continue to subsidize exam fees for all students. CSHB 3639 would revise this program, through which students receive subsidies toward the AP or International Baccalaureate Exam fees, to restrict eligibility to students based on financial need. In its *Government Effectiveness and Efficiency Report* (*GEER*), the Legislative Budget Board determined that the program was unsuccessful at increasing student achievement but caused a significant cost to the state. The incentives provided by the program have not increased the number of students successfully passing AP and International Baccalaureate exams. Changing the eligibility requirements would ensure that the state's money was spent more effectively.

Article 3. Early High School Graduation Scholarship Program. The bill would close the Early High School Graduation Scholarship Program, the scholarship program for high school students finishing in less than four years, in September 2012, and would eliminate it in 2017. There is no evidence that the program provides an effective incentive for high school students to finish early, so closing it would present an opportunity for the state to spend its money more efficiently and effectively.

Article 4. Tuition exemption. To address the growing need for more qualified teachers, Texas established the Educational Aide Exemption Program, which exempts certain educational classroom aides from tuition and some fees. Awards vary based on the number of hours taken by the student and the relative costs at the institution. The Legislature appropriated about $28.7 million to this program for fiscal 2010-11. In the current budget climate, it would be proper to target this small financial aid program toward people seeking certification in specific subject areas – like bilingual education, math, and science – that are experiencing critical teacher shortages.

The shortage of teachers in critical areas is forcing otherwise unqualified teachers into these subject areas. If there are shortages in certain subject areas, it would make sense to find ways to help a teacher attain the necessary certification to address the shortage. The tuition exemption would offer an incentive for teachers to work in disadvantaged schools.

Article 5. Partial liquidation of Permanent Health Fund. CSSB 1581 would permit the state to save money during tough economic times, while focusing available funds on the most pressing needs. The bill would allow the institutions to either spend the money or create their own endowments. It is imperative to allow the state's health-related institutions to have access to their money given the exceptionally tight state budget.

Article 6. Dual credit course offerings. Dual credit enrollment is growing rapidly in the state. Current law allows public school districts and community colleges to receive state funding for dual credit courses and requires all school districts to allow students to earn the equivalent of 12 hours of college credit while in high school. According to the LBB, from fall 2002 to fall 2009, dual credit enrollment increased more than 200 percent. Ensuring course quality and limiting dual credit courses to those with academic value would further improve college readiness.

As the numbers of enrolled students and dual credit courses have increased, ensuring the quality of dual credit programs has become more critical. In its *GEER*, the LBB said that the more limited the number of courses approved for dual credit, the easier it would be to monitor quality and to provide high school students with appropriate support. Very few dual credit courses do not count toward a certificate or degree. In general, all courses except for developmental education, basic skills, and noncredit continuing education courses can count toward a degree or certificate. Some have questioned the academic value of physical education courses for college readiness. Accordingly, the LBB recommended that physical education dual credit courses be prohibited from being available for dual credit funding. This change would not prohibit students from enrolling in and paying for physical education courses themselves.

In fiscal 2009, 1,900 Texas high school students received both high school and college credit for physical education courses. Physical education courses are not included as part of the required 36 semester-credit-hour core curriculum for colleges, so not every community college requires them to earn an associate's degree. According to the LBB, several other states do not allow physical education courses to count for dual credit.

Articles 7 and 8. Public school finance. The school finance proposal would distribute the effects of the economic crisis equally across the public schools. Those who benefited the most from funding under the target revenue system would lose more, while those who were in the formula funding system would lose less. All school districts would share in the pain, but none would be crippled. This proposal would be manageable for school districts and would set up the transition to eliminate the target revenue hold-harmless system.

Additional state aid for tax increment financing payments. SB 1581 would ensure 34 school districts were able to fulfill their tax obligations for the benefit of land zoned to enhance the area's attractiveness to new businesses. When the Legislature compressed local property-tax rates in 2006, these school districts did not have funds to pay their obligations. The bill would require state aid to be sent to these districts for this purpose.

Prekindergarten. The bill would bring much-needed accountability to prekindergarten across the state. At present, the state has no measure of the outcomes achieved from its investment in these programs. The requirement to join and pay for the certification system would not be an unfunded mandate because the state funds prekindergarten on a per student basis. Districts should use this money to meet the requirement.

OPPONENTS SAY:

Article 2. Advanced placement. The bill would not adequately define the financial need that a student would have to demonstrate to qualify for the AP subsidy.

Eliminating incentives to graduate early and to take AP courses would decrease the quality of education for all students. Some students require the monetary reward to achieve their potential by pursuing early graduation or advanced courses.

Article 4. Tuition exemptions. The bill would eliminate tuition exemptions for those who were seeking certification in subject areas not deemed to have a critical shortage of teachers. This could deny or limit access to those individuals.

Article 5. Partial liquidation of Permanent Health Fund. Once the state disperses these endowment funds, they would be lost. The fund provides a valuable source of stable, predictable funding for the state's health-related institutions. Even a partial liquidation would be short-sighted. Much like the Permanent University Fund, the Permanent Health Fund should be preserved in its entirety for the future funding of health-related institutions.

Articles 7 and 8. Public school finance. The bill could be crippling for the public schools. Low target revenue school districts cannot afford to share any more of the economic burden. These districts have been "sharing the pain" with high target revenue districts for five years. The funding gap between low and high target revenue school districts would be more than $8,200 per student.

The budget crisis and the school finance system would be best served by eliminating target revenue entirely. The target revenue hold-harmless provision is arbitrary, inefficient, and inequitable and should be eliminated before decreasing funding to school districts who receive their funding through the formulas.

Structural deficit. It is not acceptable to decrease funding to school districts to compensate for the Legislature's inability to live up to its promise to "buy down property taxes." Any legislation to fix the school finance system is futile if the structural deficit created by chronically insufficient business tax revenue is not addressed. Until additional revenue is created to support the compression of local property-tax rates, there will be a gap between state revenue and the state's obligation to the school finance system.

Proration. The proration procedure should not be changed. The current proration procedure is driven by wealth, which ensures each school district experiences the same decrease in wealth per penny.

Additional state aid for staff salary increases. The bill would create confusion by deleting a reference to the $500 for certain full-time employees, including teachers, and $250 for certain part-time employees. The bill no longer would require this funding to be certified by the commissioner for school districts and charter schools, but would not repeal the funding.

Prekindergarten. The bill would create an unfunded mandate because school districts would have to reduce the level of state funding spent in the classroom to pay for the certification system. It is inappropriate to bring

the high-stakes nature of an accountability system to the prekindergarten classroom of 3- to 4-year-olds.

OTHER OPPONENTS SAY:

Articles 7 and 8. Public school finance. The Legislature should use more of the Rainy Day Fund to support public education. The fund was created for this purpose, and the public school system is in severe distress.

NOTES:

According to the fiscal note, the changes to the calculation of Foundation School Fund entitlements would save the state approximately $4 billion in fiscal 2012-13, with a corresponding loss to local school districts.

The fiscal note assumes that the partial liquidation of the Permanent Health Fund would distribute $100 million of the total estimated fund value of $430 million. The partial liquidation would reduce interest earnings $8.5 million per biennium to recipients of the earnings.

Many of the provisions in Article 1 are found in SB 5 by Zaffirini, which passed the Senate by 30-1 (Ogden) on May 10 and passed the House, as amended, by 136-0 on May 19. Article 4 contains provisions similar to HB 3624 by Hochberg, relating to tuition exemptions for educational aides, which passed the House by 134-0 on May 13.