

# ON THE MONEY

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## School Funding in Ohio: Brief History & Overview of Current Funding

March 24, 2017 marked the 20<sup>th</sup> anniversary of the *DeRolph vs. State of Ohio* Supreme Court ruling (known commonly as “*DeRolph I*”). This seminal ruling found Ohio’s local property tax and state Foundation Formula-based system of funding K-12 public schools to be in violation of the Ohio Constitution’s language mandating “a thorough and efficient system of common schools throughout the state”. Many issues were identified in this ruling, but two of the most enduring have been Court’s judgment that the system was “overly reliant” on local property taxes, and that the Foundation formula was not based upon an objective measure of the cost of an adequate education. (A third issue relating to woefully inadequate state support for school building projects has been largely remedied through the investment of more than \$10 billion through the Ohio School Facilities Commission over the past 20 years).

After two additional rulings based upon the State’s response to the *DeRolph I*, along with an unsuccessful attempt at mediation, on December 11, 2003 the *DeRolph IV* ruling was issued which affirmed that Ohio’s school funding system was unconstitutional but also declared the case to be over. Since that time, Ohio has continued to modify its school funding formula and this edition of *On The Money* will provide a conceptual overview of the major changes and issues that have arisen in the past 20 years. The March edition of *On The Money* will provide Part 2 of this analysis - an assessment of the extent to which funding has changed for different types of districts in Ohio over the past 20 years.

### I. Basic Components of Any State’s School Funding Formula

The basic structure of Ohio’s school funding system has remained largely the same in the aftermath of the *DeRolph I* decision as it was prior to the ruling. As is the case in 49 of the 50 states in the U.S. (with Hawaii being the sole exception), school funding in Ohio is primarily based on 2 components:

#### A. Local Property Taxes

Local property taxes are used across the U.S. to fund schools and other local public services because they are traditionally very stable, which is of primary importance to local governments. Additionally, nearly 1/3<sup>rd</sup> of Ohio’s 600+ school districts supplement local property taxes with school district income taxes that typically raise a relatively small amount of revenue (in 2016 school district income taxes comprised roughly 4% of local operating tax revenues – raising slightly more than \$400 million

while property taxes for operating purposes raised \$9.957 billion.) Federal funding typically provides 7-8% of funding in most school districts and is almost exclusively targeted towards specific programmatic needs, especially for low-income students and students with disabilities.

The *DeRolph I* ruling also explicitly noted the state’s “over-reliance on local property taxes”, but did not specify exactly what problem(s) needed to be remedied. The issue of the relative roles of property taxes vs. state aid is issue will be discussed in more detail in the March issue of *On The Money*.

### ***B. State Aid through the Foundation Funding formula***

State aid is needed to supplement local property (and income) taxes in order to ensure both equity and adequacy of school funding. Because property wealth varies significantly across school districts in Ohio, wealthier districts are better positioned to provide K-12 educational services than are poorer districts. Any state’s state aid formula should address 3 primary objectives:

- 1) Determination of a ***base per pupil amount*** that ideally will reflect the cost of adequately educating a “typical” student in a “typical” school district.
- 2) Provision of ***additional funding to reflect cost differences across districts***. These cost differences derive from both differences in pupil needs (i.e. special education, career technical education, English language learners, economically disadvantaged students), as well as differences in district needs (i.e. transportation, labor market costs, diseconomies of scale due to size or population density). In Ohio, these additional funding components are often referred to as the “categoricals”. Funding amounts for the categoricals should also ideally be based on the marginal cost of adequately meeting these additional needs of pupils and districts.
- 3) Once the base cost and categorical costs have been determined, the state aid formula must also include a ***method of equitably apportioning the costs between the state and each individual school districts***. This is typically done through a calculation that reflects district property valuation and in many states the income level of district residents.

By explicitly ruling the state’s existing foundation funding formula unconstitutional on the basis of there being no objective method for determining the funding amounts, the *DeRolph I* ruling effectively mandated that the state had a responsibility to develop an objective methodology to compute adequate base cost and categorical funding levels.

Many states (including Ohio) have also added a 4<sup>th</sup> objective for the state aid formula:

- 4) Provision of ***additional funding meant to provide lower wealth school districts with the ability to expend additional resources beyond adequacy levels***. Often known as “Tier 2” funding, the objective of these funds is to allow lower wealth districts that have difficulty raising local tax revenues the same freedom to provide additional programs as that possible in wealthier districts that are able to fund such initiatives themselves.

Thus, Ohio's school funding system continues to be a combination of local property taxes and state foundation aid, with the objectives of the state aid formula being to both reduce inequities across school districts and also to ensure a minimum level of adequacy.

### **I. State Aid Step 1: Base Cost (aka Foundation Level)**

Most school funding formulas begin with a per pupil "base cost" amount. As mentioned above, this amount should reflect the cost of educating the typical pupil in the typical district.

Prior to the *DeRolph I* ruling (May 1997) there was no methodology for determining the base cost amount. In FY98 the base cost was set by the legislature at \$3,663 per pupil. Since the first *DeRolph* ruling the state has used several different methods of determining an adequate base cost amount.

From FY1999 through FY2001 a "successful schools" approach developed by school funding expert John Augenblick was used. This method identified school districts that were providing adequate outcomes (primarily measured by student performance on state proficiency tests) and then computed the average base cost in these districts.

From FY02 through FY05 a modified version of the successful school approach developed by the Ohio legislature was used to determine the base cost amount.

From FY06 through FY09 the Ohio legislature, adopting ideas first developed by Governor Taft's 2004-05 *Blue Ribbon Task Force on Financing Student Success*, modified the HB 94 outcomes based approach and turned it into an inputs based "building blocks" approach. The rationale behind this change was that it is easier to make year-to-year adjustments in input criteria and related costs than it is to adjust an outcomes based model. In FY09, the last year of the building blocks, the base cost was set at \$5,732 per pupil.

In FY10 and FY11 school funding was based on Governor Strickland's "Evidence Based Model" for school funding (EBM) which was essentially an inputs based approach rooted in research-based costs. The EBM was constructed in such a way that it did not rely on a single base cost figure.

In FY12 and FY13 (Governor Kasich's first budget) threw out the EBM and used the "Bridge Formula". This was really not a funding formula at all, but rather a method for basing FY12 and FY13 state aid on FY11 funding levels. This was necessary in the aftermath of the 2009 recession that left the state budget in a precarious state of structural imbalance.

In FY14 the Base Cost was set by the legislature at \$5,745 per pupil and has increased to \$5,800 in FY15, \$5,900 in FY16 and \$6,000 per pupil in FY17. The FY18-19 budget enacted in June increased the base cost to \$6,010 in FY18 and to \$6,020 per pupil in FY19.

These base costs figures are no longer linked to any methodology for determining an adequate level of funding. This component is now known as "Core Opportunity Aid".

Table 1 below provides a summary of the base cost "Foundation Level" from FY1990 through FY2019.

**Table 1: Ohio Foundation Level and Percent Change, FY1990–FY2019**

<b>Year</b>	<b>Foundation Level</b>	<b>% Increase</b>		<b>Year</b>	<b>Foundation Level</b>	<b>% Increase</b>
FY 1990	\$2,530	7.2%		<b>FY 2005</b>	\$5,169	2.2%
FY 1991	\$2,636	4.2%		<b>FY 2006</b>	\$5,283	2.2%
FY 1992	\$2,710	2.8%		<b>FY 2007</b>	\$5,403	2.3%
FY 1993	\$2,817	3.9%		<b>FY 2008</b>	\$5,565	3.0%
FY 1994	\$2,871	1.9%		<b>FY 2009</b>	\$5,732	3.0%
FY 1995	\$3,035	5.7%		<b>FY 2010</b>	EBM	--
FY 1996	\$3,315	9.2%		<b>FY 2011</b>	EBM	--
FY 1997	\$3,500	5.6%		FY 2012	Bridge	--
FY 1998	\$3,663	4.7%		FY 2013	Bridge	--
FY 1999	\$3,851	5.1%		FY 2014	\$5,745	0.2%
FY 2000	\$4,052	5.2%		FY 2015	\$5,800	1.0%
<b>FY 2001</b>	\$4,294	6.0%		FY 2016	\$5,900	1.7%
<b>FY 2002</b>	\$4,814	12.1%*		FY 2017	\$6,000	1.7%
<b>FY 2003</b>	\$4,949	2.8%		FY2018	\$6,010	0.2%
<b>FY 2004</b>	\$5,058	2.2%		FY2019	\$6,020	0.2%

\* The increase of 12.1% in FY02 is much greater than in other years because it was accompanied by a reduction in the “Cost-of-Doing-Business” adjustment factor from 13.8% to 7.5%.

As summarized above, the eleven years from FY01 through FY11 reflect the period of time where an adequacy method was used to determine the base cost level of funding.

## **II. State Aid Step 2: “Categorical” Funding**

School funding formulas must also provide funding to districts for delivering services that impose exceptional costs. Ohio’s school funding formula currently includes additional categorical funding in these areas:

- Special Education
- Career Technical Education (Voc. Ed)
- Limited English Proficient (LEP) Student funding
- Economically Disadvantaged Student Aid
- K-3 Literacy programs
- Gifted and Talented Student funding
- Pupil Transportation

Additional funding for LEP students and for K-3 literacy have been added since the *DeRolph I* ruling. Prior to the *DeRolph I* ruling, special education and career technical education funding was based on educational “units” and was both under-funded and not linked to the base cost amount. The lack of linkage to base cost meant that funding for these services would often lag behind basic foundation funding creating what became

known as the “parity issue”. In the aftermath of the *Derolph* ruling special education and career technical education funding was converted to a “weighted pupil” system which addressed the parity issue. The special education weights were originally based on a cost analysis, however, this analysis is now well out of date. Additionally, special education career technical education, LEP, and K-3 literacy funding are no longer based on weights but on per pupil amounts. None of these figures are currently linked to cost estimates.

Additional funding for economically disadvantaged students has been part of Ohio’s funding formula for at least 30 years. The economically disadvantaged student funding component is currently designed so that districts with higher concentrations of economically disadvantaged students receive additional funding at a higher per pupil level than do districts with fewer low income students. However, there has never been a comprehensive study designed to assess the actual additional costs imposed by poverty. A legislative Task Force focusing on Education and Poverty has been meeting since the summer of 2017 to examine this issue.

### **III. State Aid Step 3: Determination of State vs Local Share of Funding**

Once the per pupil base cost and categorical funding amounts have been determined, the final step of the school funding formula is to determine how to apportion the cost between the state and each local school district.

For many years the local share was determined by using a millage “chargeoff”. The chargeoff approach multiplied a fixed millage amount times each districts’ total property wealth to determine the local contribution. This resulted in wealthier districts paying more locally and poorer districts receiving more state aid. The chargeoff millage amount fluctuated between 20 and 23 mills over time.

Since FY14-15 the funding formula has used a “State Share Index” (SSI) approach. The SSI is a complicated formula that takes into account each district’s property wealth per pupil along with 2 different income measures in order to compute a “wealth index”. Districts are ranked by wealth and the state share ranges from 5% in the wealthiest districts to 90% in the poorest district. The SSI remains the same during both years of each biennium and is applied to Core Opportunity Aid (base cost) and to most of the categoricals.

When the SSI was recomputed for the FY16-17 biennium, 389 districts saw their state share decrease. When the SSI was recomputed for the FY18-19 biennium, 373 districts saw their state share decrease. The decrease in the SSI for 60% of Ohio’s school districts in combination with the modest \$10 per pupil increase in the base cost figure in FY18 and FY19 have led to a significant increase in the number of districts on the transitional aid guarantee in Ohio.

### **IV. “Tier 2” Funding: Targeted Assistance and Capacity Aid**

The final pieces of the state funding formula are known as Targeted Assistance and Capacity Aid. Both of these components provide additional assistance to low wealth school districts under the rationale that they are less able to raise additional funds locally because of their low tax base.

Targeted Assistance (originally known as “Parity Aid”) provides additional state aid to districts that are below the 80<sup>th</sup> percentile in wealth per pupil. Capacity Aid was added to the formula in FY16 and provides additional state aid to districts that are below the statewide median in property tax revenue raised by 1 mill of tax effort. In Fy17 Targeted Assistance provided an additional \$905 million to Ohio school districts while Capacity Aid provided an additional \$174.5 million in funding.

By providing nearly \$1.1 billion in additional state funding to districts that have greater challenges raising money locally, these two components are a particularly important improvement to the funding formula in the aftermath of the *DeRolph* rulings.

## V. Additional Funding Formula Issues

- **The Gain Cap** – a relatively recent aspect of Ohio’s school funding formula is the “gain cap”. This is a provision that limits the increase in state aid that a district can receive in any given year. In FY16 and Fy17 the gain cap was 5% per year. In FY17, 151 districts were limited by the gain cap, with a total amount “owed” to them by the state of \$493 million. In FY18 and FY19 the gain is cap is 3% per year for most districts and LSC has estimated that 173 districts will be limited by the cap at an amount of \$522 million.
- **The Transitional Aid Guarantee** - the “guarantee” is a long-standing provision of Ohio’s school funding formula which has worked to limit reductions in state funding to school districts as the formula is recomputed annually. The reason for the guarantee is to preserve continuity of funding for districts facing changing circumstances. The three primary reasons that a district may end up “on the guarantee” are a) changes in the number of students over time; b) changes in property valuation over time; and c) changes in the funding formula itself. In FY17 133 districts were on the guarantee at an additional cost of \$104 million. LSC has estimated that in FY18 the guarantee will increase to 317 districts with a cost of \$205 million. The primary reason for the large increase in districts on the guarantee in FY18 is the relatively small increase in formula funding from FY17 to FY18 which was insufficient to offset the reduction in the state share index for over 60% of Ohio’s school districts.
- **Community School Deduction** – Community schools (known as “charter schools” in most other states) are funded on a pass-through basis in Ohio. Rather than being funded directly by the state, community school students are counted in the formula ADM of the school district in which the student resides and the funding is then deducted from the state aid received by the school district. The community school deduction has caused significant controversy over the years as districts only receive the state share of funding for these students from the state yet see 100% of the funding deducted from their state aid. This is mathematically equivalent to diverting local district resources to community schools.

## VI. Conclusion

The preceding summary provides a basic overview of the primary components of Ohio’s school funding formula and some context for evaluating it in light of the *DeRolph*

rulings. Clearly, much progress has been in the 20 years since the *DeRolph I* decision. Thousands of new and renovated buildings now house Ohio public school students in hundreds of districts. Funding for K-12 schools overall has increased significantly. However, the state has now returned to the pre-*Derolph* situation where the funding formula parameters are no longer linked to costs. The March issue of *On The Money* will provide a more detailed assessment of how state and local funding has changed over time, which types of school districts have benefited the most, and the extent to which the reliance on property taxes has been altered.

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