

ANNUAL REPORT ON FISCAL CAPACITY

TENNESSEE ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS

June 20, 2013

Four Steps in Determining BEP Funding

- 1. Basic Education Program Funding Formula:** Establishes total amount needed by each school system
- 2. Local Share, State Share:** Set by law to divide responsibility between the state and local governments
 - **Instructional costs:** 30% local, 70% state (phasing up to 75% state via appropriations bill)
 - **Other classroom costs:** 25% local, 75% state
 - **Non-classroom costs:** 50% local, 50% state
- 3. Fiscal Capacity:** Used to allocate local share among counties
- 4. State makes up the difference:** total cost of the BEP minus the local share for each school system

Fiscal Capacity

- The fiscal capacity model helps determine how much local governments have to contribute to the BEP for each school system
- Measure of the potential ability of local governments to fund education from their own taxable sources, relative to their cost of providing services
 - Estimates how much revenue per pupil each county area can afford to raise for education.
- A county level model
 - 95 counties but 136 school systems
 - Each system within a county will have the same fiscal capacity

Method

- The model is based on a set of averages drawn from actual spending, revenue, income, etc.
- Multiple regression analysis is used to describe the relationship between own source revenue per pupil and each of the other factors (variables)
 - Takes each variable and simultaneously compares it for all counties to calculate weights (called coefficients)
 - Multiplies weights by the factors for each county to produce the closest estimates of actual local revenue for all 95 counties
- Multiple regression analysis is a common statistical method used to understand relationships among factors for a wide range of issues

Factors Used to Determine Fiscal Capacity

- **Own-Source Revenue Per Pupil:** This is the amount of local money that the school systems in the county report that they spend on education divided by enrollment (average daily membership (ADM)).
- **Taxable Sales Per Pupil:** The locally taxable sales for the county area divided by ADM. This is a measure of the local ability to raise revenue.
- **Equalized Property Assessment Per Pupil:** The total assessed property value for the county area, equalized across counties using appraisal-to-sales ratios, and then divided by ADM. This is also a measure of the local ability to raise revenue.
- **Equalized Residential and Farm Assessment Divided by Total Equalized Assessment (Tax Burden):** This is a proxy for a county's potential ability to export taxes through business activity. A high residential and farm ratio indicates a low level of business activity and a potential for higher tax burdens on county residents.
- **Per Capita Income:** Per capita income is included in the fiscal capacity model as a proxy for county residents' ability to pay for education and for all other local revenue not accounted for by property or sales taxes.
- **ADM Divided by Population (Service Burden):** This measure is included as a reflection of spending needs. The larger the number of public school students per 100 residents, the greater the fiscal burden for each taxpayer.

Effect of Changes in Fiscal Capacity Factors

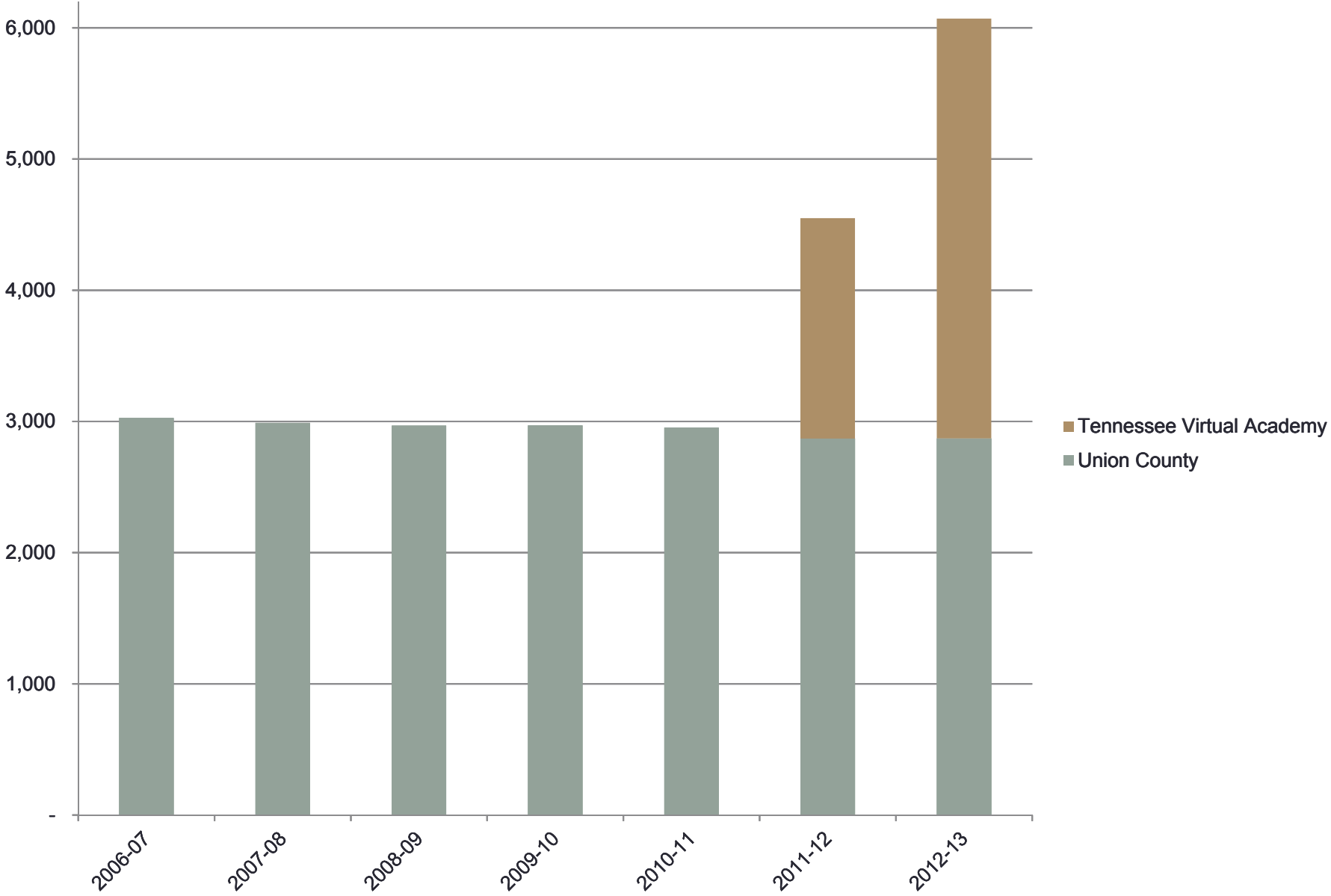
The relationship between fiscal capacity and specific variables (other things being equal) is illustrated as follows:

Property Tax Base Increases	↑	Fiscal Capacity Increases	↑
Sales Tax Base Increases	↑	Fiscal Capacity Increases	↑
Per Capita Income Increases	↑	Fiscal Capacity Increases	↑
Residential/Farm Share of Property Increases	↑	Fiscal Capacity Decreases	↓
Service Burden Increases	↑	Fiscal Capacity Decreases	↓
Number of Students Increases	↑	Fiscal Capacity Decreases	↓

Virtual school students effect on fiscal capacity and K-12 funding.

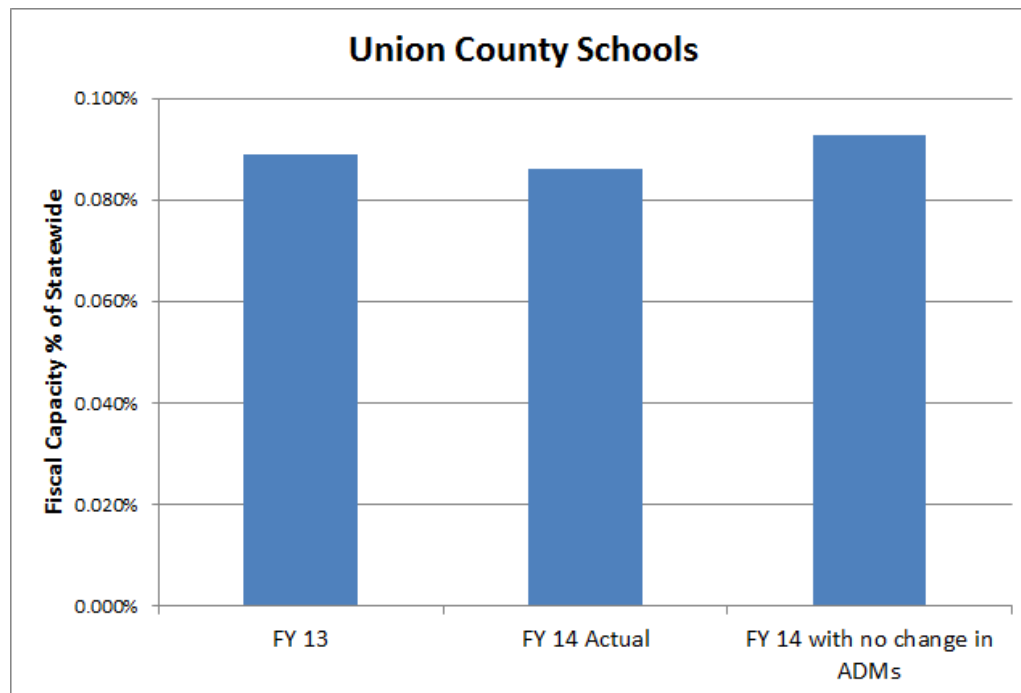
- The Virtual Public Schools Act, Public Chapter 1096, Acts of 2008
- 2011-12, Union County contracted with a private company to operate a virtual school
- TN Virtual Academy serves students in grades K-8 from across the state
- Students are treated for fiscal capacity and funding purposes as enrolled in Union County schools
- Enrollment was 1,679 in 2011-12 and is an estimated 3,200 in 2012-13.

Union County Students



Union County's share of statewide fiscal capacity would have increased. Instead, it will decrease.

- Ranked 80th in fiscal capacity in FY 2013
- Ranked 81st for 2014
- Would have ranked 79th with no virtual school students



Virtual school students affect the Basic Education Funding formula.

- BEP total cost increases
 - Majority of students in virtual school did not come from public schools
- Total local share increases
- More state funding for Union County
 - Funded for more students but responsible for a smaller percentage of total local share

As fiscal capacity for Union County decreases, the amount the other 94 counties are responsible for increases.

