



ANNUAL REPORT ON FISCAL CAPACITY

TENNESSEE ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS

June 12, 2014

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

- Answers the question: How much must each local government contribute to the BEP?
- Measures: The potential ability of local governments to fund education from their own taxable sources, relative to their cost of providing services.
- County-level model: All systems within each county pay the same percentage of their BEP allocation.

Method

- A set of averages drawn from actual tax bases, income, etc. is compared with actual revenue.
- The amount of weight to give each factor is determined by estimating the statistical relationship between them.
- Multiple regression analysis
 - a common statistical method used to understand relationships among factors for a wide range of issues
 - Simultaneously compares all variables for all counties to determine how much weight to give each factor
- Weights are multiplied by the factors for each county to estimate potential local revenue for each of the 95 counties.
- Actual revenue is used as a control.

Factors Used to Determine Fiscal Capacity

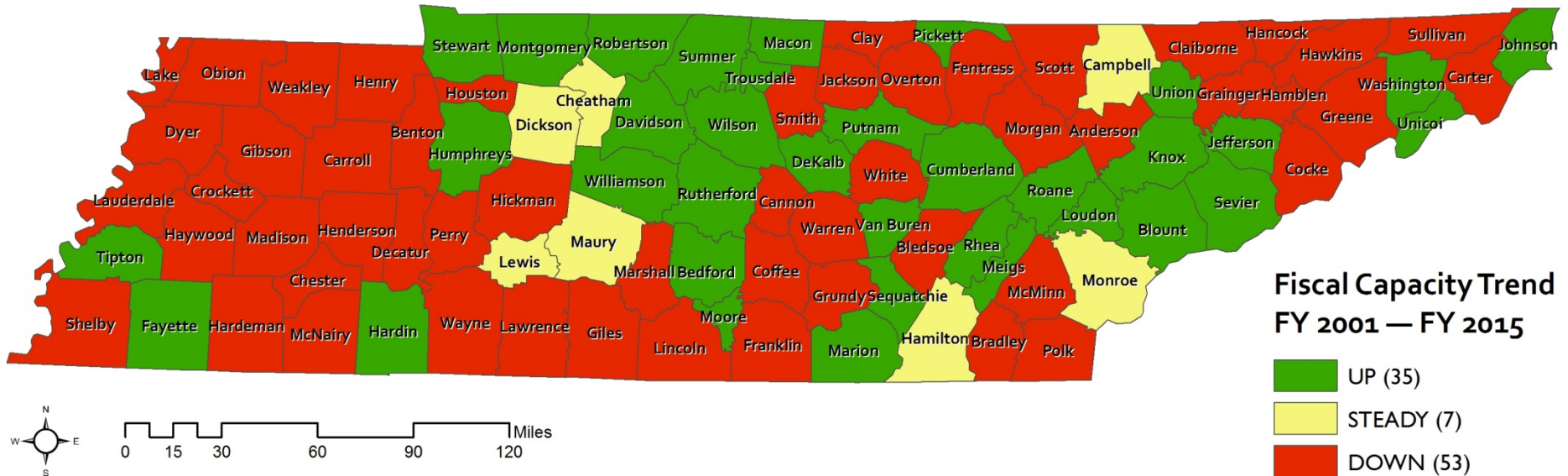
- **Own-Source Revenue Per Pupil:** The actual amount of money local governments raise to fund their schools divided by enrollment (average daily membership(ADM)), the control factor that keeps the estimates within the bounds of what local governments actually do.
- **Taxable Sales Per Pupil:** The locally 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):** A proxy for a county's potential ability to export taxes through business activity—the higher this number, the lower the level of business activity and the higher the risk of heavy tax burdens on county residents.
- **Per Capita Income:** 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):** 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)

| Factor Increases... | Effect of Fiscal Capacity | |
|--|----------------------------------|---|
| 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 | ↓ |

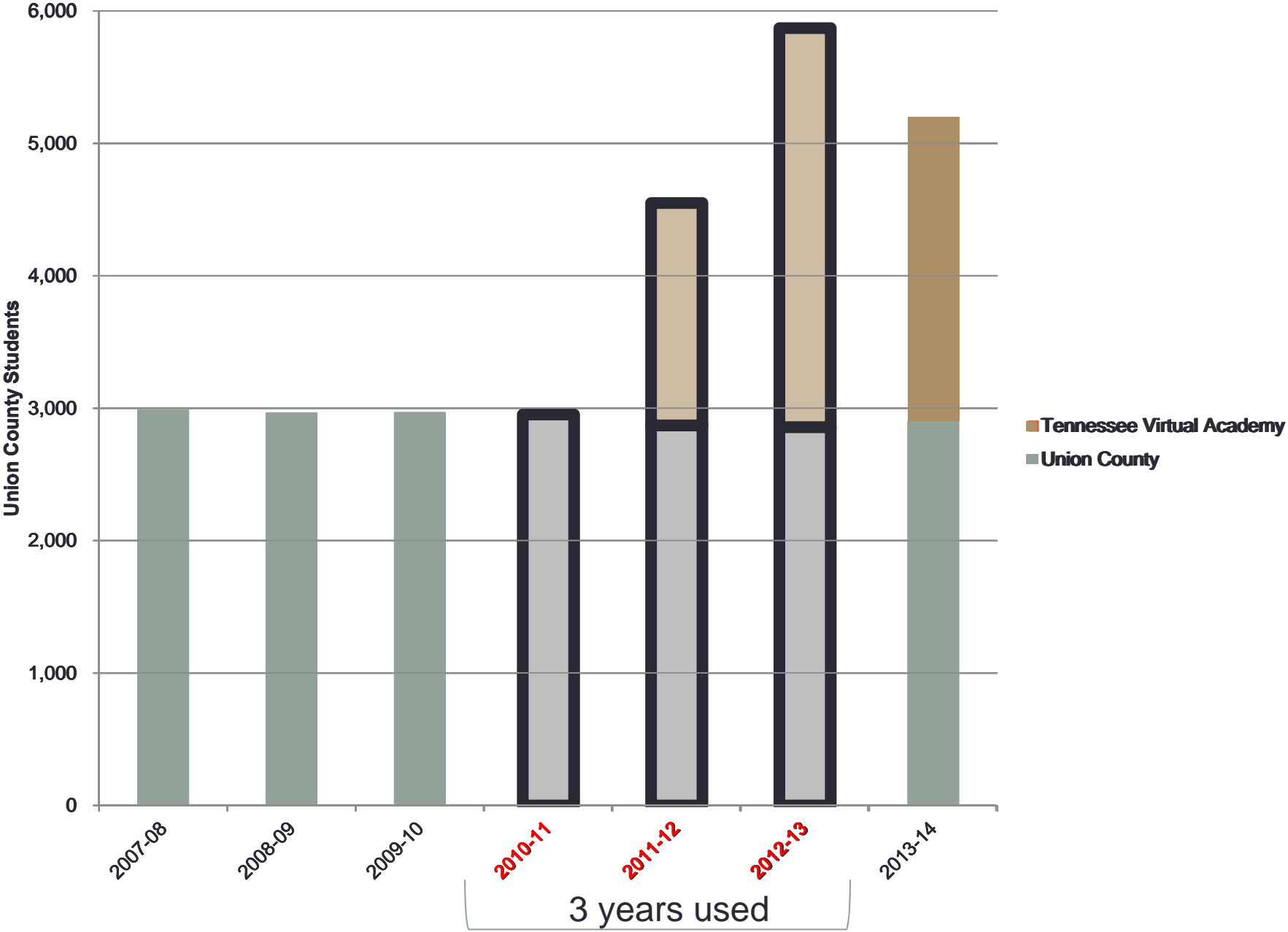
Long Term Fiscal Capacity Trends by County FY 2001 to FY 2015



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
- The virtual school's enrollment was 1,679 in 2011-12 and 3,014 in 2012-13.
- The virtual school's enrollment is estimated to be about 2,300 for 2013-14, a decline of 700 students.

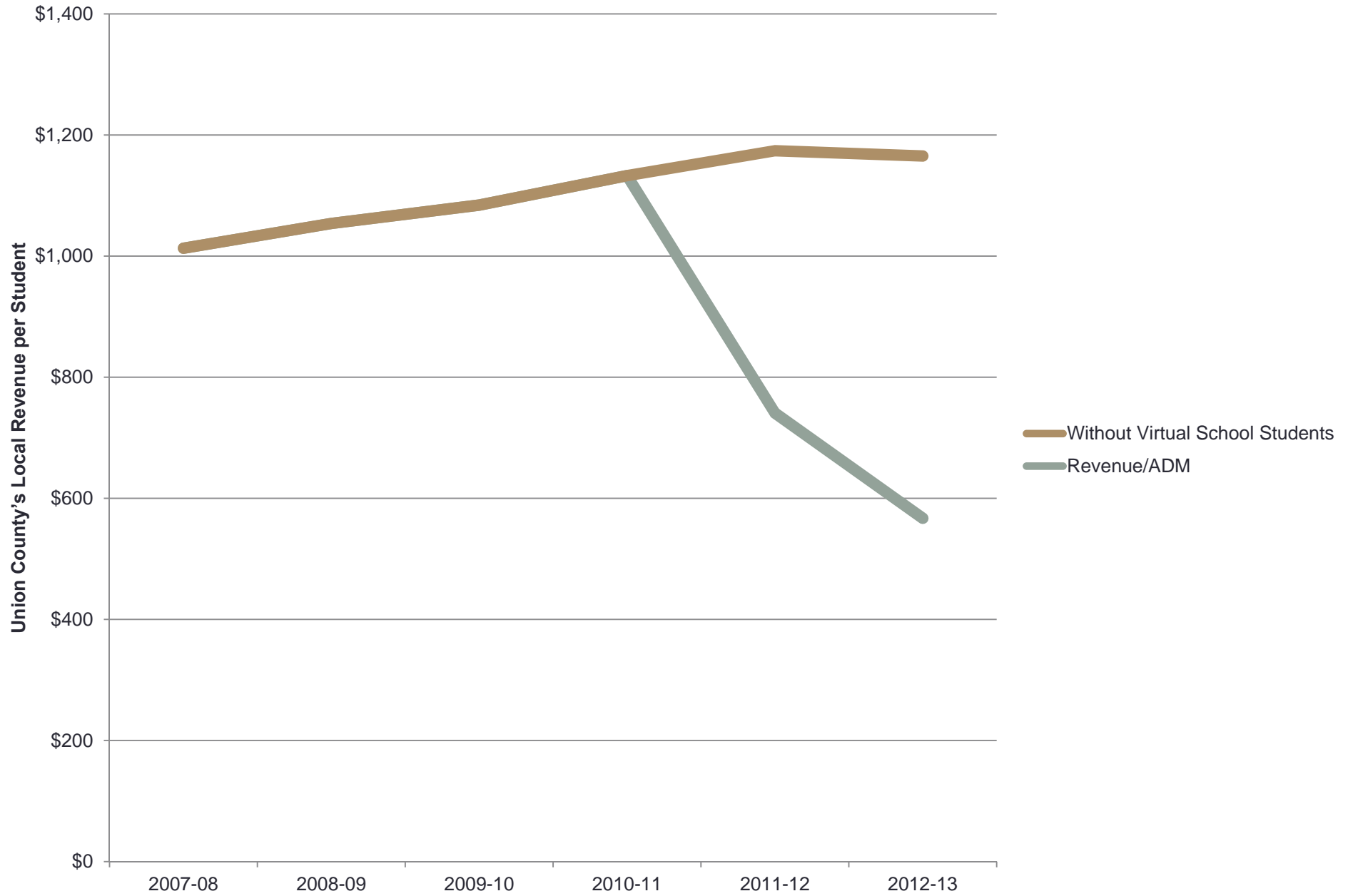
Union County Students



Without virtual school students, Union would have ranked 123rd in Revenue per ADM from 2010-11 through 2012-13. With virtual school students, Union fell to last.

| Without virtual school students (2012-13) | | | With virtual school students (2012-13) | | |
|---|---------------------|-----------------|--|---------------------|------------|
| Rank | System | Rev./ADM | Rank | System | Rev./ADM |
| 123 | Union County | \$ 1,165 | 123 | Wayne County | \$ 1,116 |
| 124 | Wayne County | 1,116 | 124 | Scott County | 1,111 |
| 125 | Scott County | 1,111 | 125 | Lauderdale County | 1,106 |
| 126 | Lauderdale County | 1,106 | 126 | Grainger County | 1,010 |
| 127 | Grainger County | 1,010 | 127 | Bells City | 989 |
| 128 | Bells City | 989 | 128 | Houston County | 965 |
| 129 | Houston County | 965 | 129 | Crockett County | 958 |
| 130 | Crockett County | 958 | 130 | Chester County | 944 |
| 131 | Chester County | 944 | 131 | Hancock County | 932 |
| 132 | Hancock County | 932 | 132 | Grundy County | 900 |
| 133 | Grundy County | 900 | 133 | Alamo City | 874 |
| 134 | Alamo City | 874 | 134 | Morgan County | 872 |
| 135 | Morgan County | 872 | 135 | Stewart County | 708 |
| 136 | Stewart County | 708 | 136 | Union County | 567 |

Union County's Local Revenue per Student



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