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Annual Report on Fiscal Capacity

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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 salary and wages costs**: 30% local, 70% state
    - **Instructional benefit costs**: 30% local, 70% state
    - **Other classroom costs**: 25% local, 75% state
    - **Non-classroom costs**: 50% local, 50% state
        – School system will receive no less than a 25% state share in non-classroom components (Davidson and Sevier receive a 25% state share in non-classroom because of this provision)
3. **Fiscal Capacity:** Used to allocate local share among counties **50-50 TACIR-CBER**
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 in TACIR's Fiscal Capacity Regression

- **Own-Source Revenue Per Student:** 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.
- **Sales Tax Base Per Student:** 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 Student:** 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.

Factors Used in TACIR's Fiscal Capacity Regression (cont.)

- **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	↓

County Trends in Share of Statewide Fiscal Capacity

- The change in a county's share of statewide fiscal capacity depends on its growth in fiscal capacity relative to the 95-county average growth in fiscal capacity.
- A county whose fiscal capacity grows faster than the 95-county average will increase its share and vice versa.

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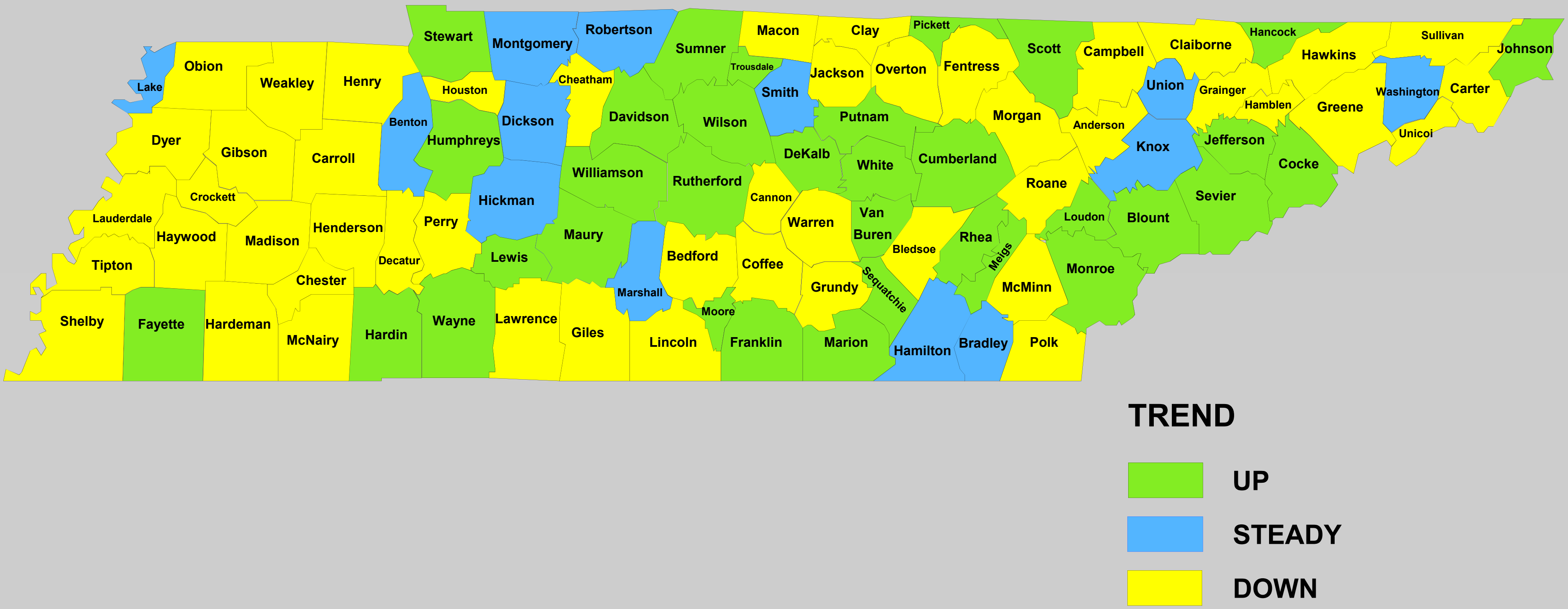
Long Term Fiscal Capacity Trends by County

5-year average (2015-16 to 2019-20) compared with 15-year average (2005-06 to 2019-20)



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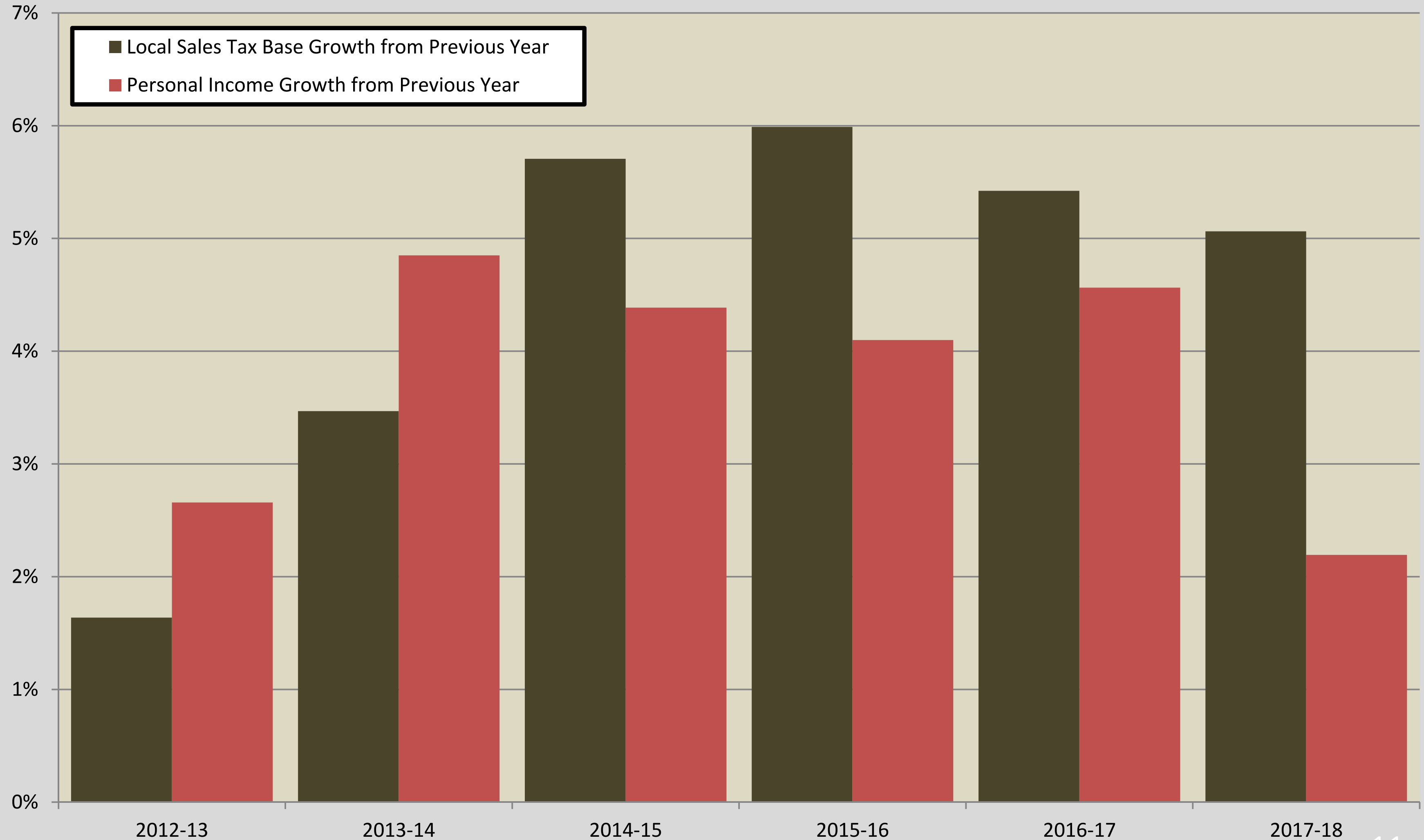
Legislative Update: Local Option Sales Tax

- Rule 129 enforced (October 1), which requires out-of-state sellers with no physical presence in the state with sales of more than $500,000 in Tennessee to collect and remit sales tax.
- Fiscal Note
  - $17.7 million in FY 2019-20.
  - $23.6 million in subsequent years.
- The 2017 fiscal note was $59.4 million per year.

Annual Growth in Personal Income and Local Option Sales Tax Bases in Tennessee, Fiscal Years 2012-13 to 2017-18



Sources: US Bureau of Economic Analysis (Personal Income) and Tennessee Department of Revenue (Local Sales Tax Base).

Legislative Update: Local Option Sales Tax

- Eliminated the uniform 2.25% rate option for out-of-state sellers with no physical presence in the state
  - These collections were $401.6 million in FY 2017 and $368.2 million in FY 2018.
  - Distribution was based on local jurisdictions' percent of statewide.
  - Distribution of the revenue will be based on the destination of the sales.

Per Capita Income Revisions were Significant

- Revisions to per capita income averaged 2.8% (2015) and 3.1% (2016) this year.
- This compares with 0.3% (2014) and 0.7% (2015) last year.

Personal Income Residence Adjustment

- Personal income
  - is a measure of income by county of ***residence***.
  - is adjusted for commuters leaving or entering a county (the residence adjustment).

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Bureau of Economic Analysis Explanation of Revisions to Per Capita Personal Income Estimates

“The revisions to per capita personal income in 2015 and 2016 in Bledsoe, Decatur, and Van Buren (Tennessee) counties were caused by revisions to the county estimates of residence adjustment which were updated to incorporate new commuting information from the 2011-2015 American Community Survey (ACS) 5-year estimates from the U.S. Census Bureau. Previously, the estimate of county residence adjustment for 2015-2016 were based on 5-year ACS estimates for 2006-2010.”

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Per Capita Income Revisions

	2015	2016
5 Largest Positive Revisions		
Decatur	20.3%	20.8%
Bledsoe	20.3%	19.7%
Van Buren	13.6%	11.8%
Perry	10.2%	10.4%
DeKalb	9.6%	10.3%
5 Largest Negative Revisions		
Wayne	-4.8%	-4.9%
Clay	-4.8%	-5.4%
Lake	-5.6%	-5.6%
Trousdale	2.2%	-15.0%
Benton	-6.7%	-7.1%

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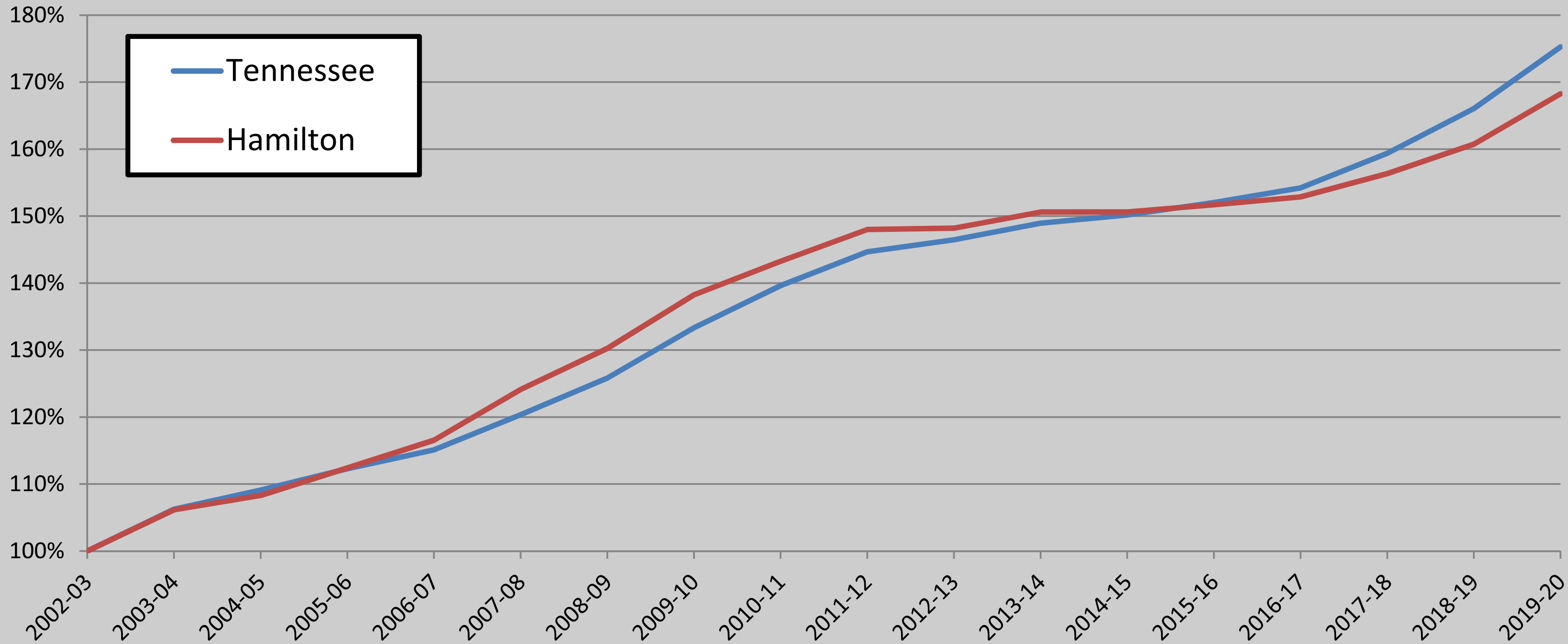
Combined Tax Base per Student (Sales and Property) as a Percentage of 2001-02 Combined Tax Base per Student

*2002-03 to 2019-20 Models**



*Fiscal capacity models use three-year average tax bases.

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As fiscal capacity for a county decreases, the other 94 counties are responsible for a greater share of the BEP local match.