



Legislative Council Staff

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Memorandum

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October 17, 2018

TO: Interested Persons

FROM: Marc Carey, Economist, 303-866-4102

SUBJECT: School Finance and the Constitution

Summary

The financing of K-12 public education in Colorado over the past three decades has been affected by three constitutional amendments: the Gallagher Amendment, the TABOR Amendment, and Amendment 23. Combined with the results of key court cases, these amendments have created a complex educational funding system for the General Assembly to negotiate. Diminished tax revenue during recessionary periods has also contributed to the struggle for state and local governments to maintain consistent K-12 public education funding levels.

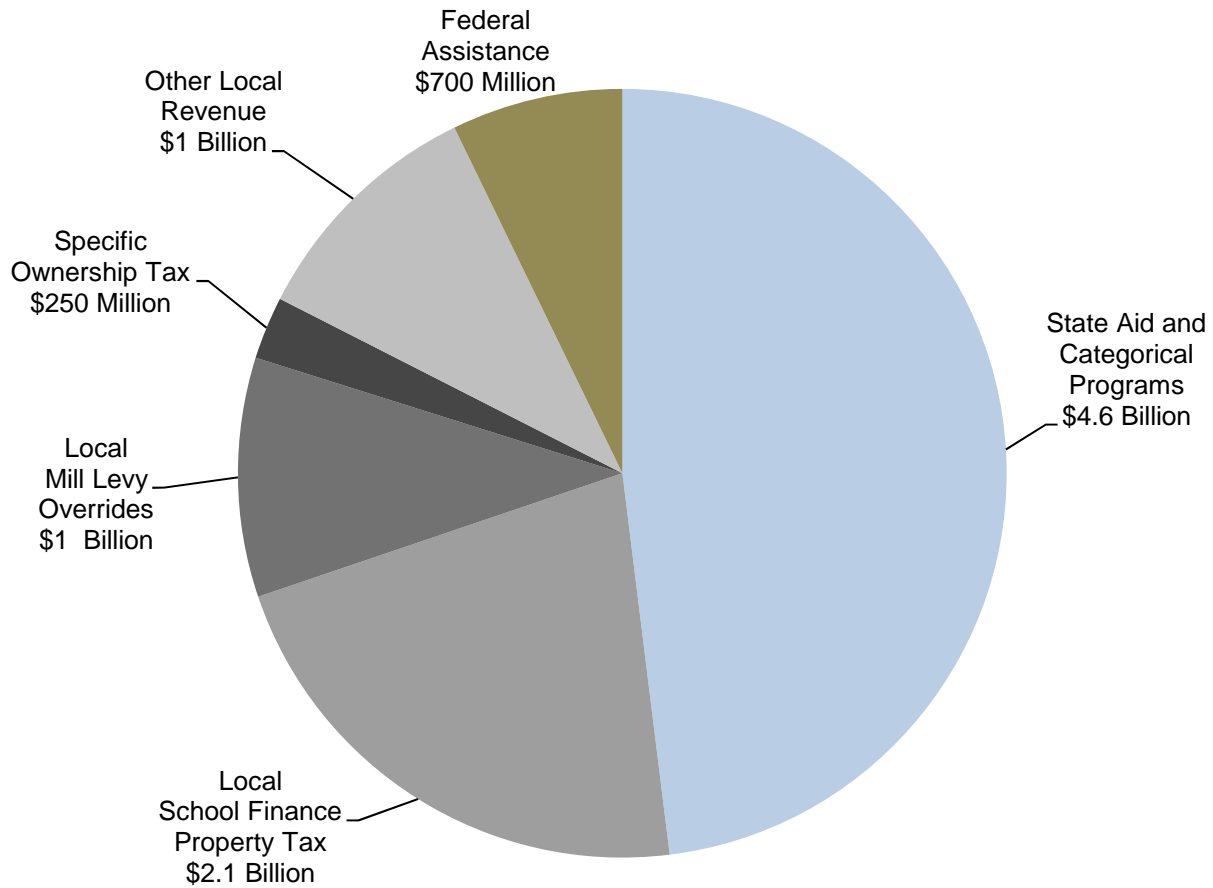
In Colorado, the state, in partnership with local governments, has the responsibility for funding K-12 public education. Each year, the General Assembly passes the school finance bill that amends the Public School Finance Act of 1994 (Act) to allocate state and local tax revenue for the operation of schools in 178 school districts across the state.¹ The Act contains a formula which estimates a funding target for each district based on pupil count and a variety of other factors. Historically, when local tax collections are insufficient to meet estimated funding requirements state funding makes up the difference. Recent legislative changes have altered this funding structure, and the General Assembly now budgets K-12 funding to a level that is less than formulaic funding requirements. School district operating budgets also include federal money, other local revenue, and money from private contributions that are not allocated through the Act. Figure 1 provides an overview of all Colorado school district operating revenue sources in FY 2014-15, the latest year for which all data are available. This does not include money for capital expenditures.

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¹For a detailed discussion of the school funding formula in the Public School Finance Act of 1994, see "School Finance in Colorado." https://leg.colorado.gov/sites/default/files/images/2018_school_finance_booklet_-_final.pdf

Figure 1
School District Operating Funding, FY 2016-17
Total: \$9.6 Billion or \$11,184 Per Pupil



Source: Colorado Department of Education.

Overall, state revenue sources contributed about 48 percent of total operating revenue, local sources contributed about 45 percent, and federal sources about 7 percent.

This document provides information on the cumulative impact of these constitutional and statutory provisions, the constraints they create for public school funding, and the actions taken by the General Assembly and school districts to fund education and balance the budget during periods of limited tax revenue. Specifically, this document provides:

- a brief overview of the Act and its formula for allocating K-12 funding;
- a review of the three constitutional amendments that impact K-12 funding—the Gallagher Amendment, the TABOR Amendment, and Amendment 23;
- the General Assembly's response to the budgetary pressures resulting from these constraints combined with periods of economic downturn; and
- the response of school districts to budget pressures resulting from state funding cuts and the recession.

Overview of the School Finance Act

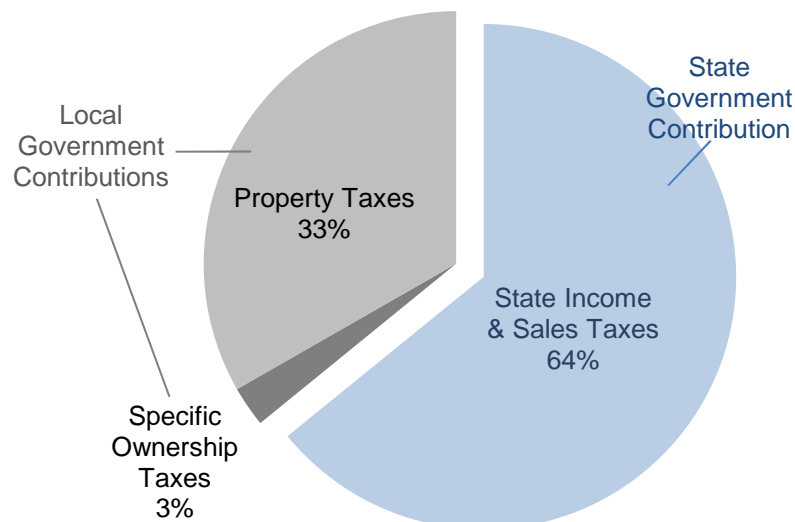
The School Finance Act of 1994 governs a majority of K-12 public education funding in Colorado and implements the constitutional requirement to provide for the establishment and maintenance of a thorough and uniform system of free public education.

Equalization. Historically, funding for public schools came primarily from local property taxes. Following a series of court cases nationwide, state legislatures were required to adopt laws providing state money for public schools to ensure local school districts with limited property value received an equitable amount of funding.² This additional money, meant to equalize funding across school districts, is known as state aid.

In Colorado, the total K-12 public education funding target for each school district, generally referred to as total program, is calculated using constitutional requirements combined with a statutory formula. The Act requires local governments to contribute revenue to fund the operation of their schools, but these amounts vary across school districts. If a district's local tax revenue is insufficient to fund the district's total program, the state is required to make up the difference with state aid.

Who pays for the Act? School districts are usually funded with a combination of local and state money. The majority of state aid comes from state income taxes and sales taxes. Local school districts raise money from property taxes on real estate and business equipment and from specific ownership taxes on motor vehicles. Figure 2 depicts the relative proportions of the state and local contributions to school finance in the current fiscal year.

Figure 2
State and Local Contributions to the School Finance Act, FY 2018-19
Total Funding: \$7.1 Billion



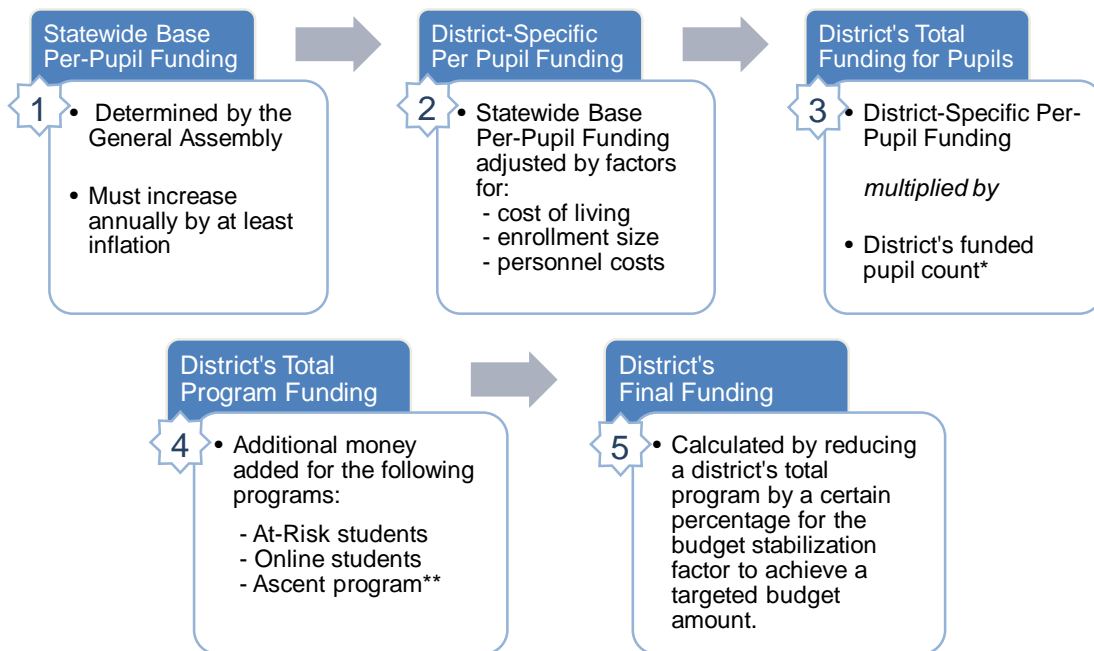
Source: Joint Budget Committee Staff.

²*Robinson v. Cahill*, New Jersey Supreme Court, 1973 and *Abbott v. Burke*, New Jersey Supreme Court, 1981; *Lujan v. Colorado State Board of Education*, 1982, *Rose v. Council for Better Education*, Kentucky Supreme Court, 1989, *McDuffy v. Secretary*, Massachusetts Supreme Court, 1993, and *Campaign for Fiscal Equity v. State*, New York State Court of Appeals, 1993.

Schools districts also receive federal money for specific programs and they may raise additional money on their own. For example, the federal government provides Title I aid to districts with a high percentage of low-income students and provides special education funding for the instruction of students with disabilities.³ School districts may also raise additional local revenue in a number of ways. For example, districts may submit ballot questions to voters to provide override revenue, charge fees for services, or raise money for other purposes such as transportation or full-day kindergarten. Districts and schools may also apply for and receive state and federal grants or private contributions.

The formula. In FY 2018-19, the Act will distribute nearly \$7.1 billion in state and local money to the state's 178 school districts. This allocation is accomplished through use of a formula that calculates a per pupil funding amount for each school district based on the individual characteristics of the district, such as the number of students enrolled and the average cost to live in the district. The basic steps of the school finance formula are depicted graphically in Figure 3 below.

Figure 3
Formula Used to Calculate District-Specific Per-Pupil Funding in the School Finance Act



*Funded pupil count is defined as a district's preschool count plus online and ASCENT counts plus .08 times the Kindergarten count plus the maximum of the district's current K-12 October count or a two, three, four, or five-year average of the October counts.

**ASCENT is a program allowing students to complete a fifth year of high school while concurrently enrolled in higher education courses.

The calculation of each district's per pupil funding begins by determining a statewide base per pupil funding level. Base per pupil funding is set annually by the General Assembly, as specified by requirements in the Colorado Constitution. The constitution requires that the base funding level increase annually by at least the rate of inflation.

³Much of the federal funding for education comes for specific programs or purposes.

Base per pupil funding is then adjusted by a series of factors meant to account for differences in district size, local cost of living, and the share of operational costs dedicated to personnel. State law specifies how these factors are set and applied to the base per pupil amount. Generally, smaller districts with a high cost of living will receive more per pupil funding than a larger district with a low cost of living. Districts also receive additional funding if they serve a higher percentage of at-risk students; and all districts receive the same per pupil funding to pay for online or ASCENT students.

Beginning in FY 2010-11, the Act contained a new element called the budget stabilization factor. This factor is applied after all the other funding adjustments, and reduces total program funding proportionately for most districts. The budget stabilization factor reduces the amount of state aid that each district receives by cutting the contributions from the other factors, so that base funding is not affected. Districts that do not receive enough state aid to fully implement the required funding reduction must instead offset state spending on categorical programs in their district with local funding to the degree possible.

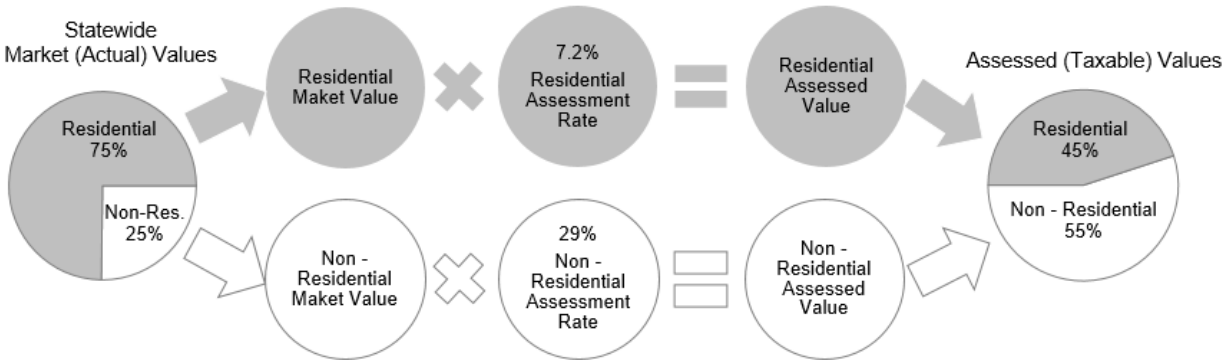
Constitutional Constraints on Public School Funding

Funding for K-12 education through the Act has been impacted by three amendments to the State Constitution: the Gallagher Amendment, the TABOR Amendment, and Amendment 23. The following section provides an overview of the relevant provisions of each amendment and how these impact state and local revenue sources that support public education funding. In addition, this section reviews the ways in which these provisions interact with one another and the impacts these can have on public education funding.

Gallagher Amendment. The Gallagher amendment was adopted by voters in 1982. Designed to reduce residential property taxes, the amendment requires that the residential assessment rate, which is used to determine the taxable value of residential property, be adjusted every two years to maintain a fixed, proportional relationship between the assessed value of residential and nonresidential property. Initially, about 45 percent of statewide assessed value was attributed to residential property and 55 percent was attributed to nonresidential property, although these percentages are not set in statute. As depicted in Figure 4, the Gallagher Amendment affects property tax revenue by adjusting assessment rates for residential property to maintain this proportional relationship. In particular, the amendment requires the assessment rate for residential property to:

- *fall* if the actual value (or market value) of residential property grows faster than nonresidential property statewide or the actual value of residential property falls more slowly than nonresidential property statewide; or
- *rise* if the actual value (or market value) of residential property grows more slowly than nonresidential property or the actual value of residential property falls more rapidly than the value of nonresidential property.

Figure 4
How Gallagher Works to Alter the Residential Assessment Rate (RAR)



The Residential Assessment Rate (RAR) is smaller than the nonresidential rate because the share of residential property needs to shrink from 75 percent of market value to 45 percent of assessed (or taxable) value.

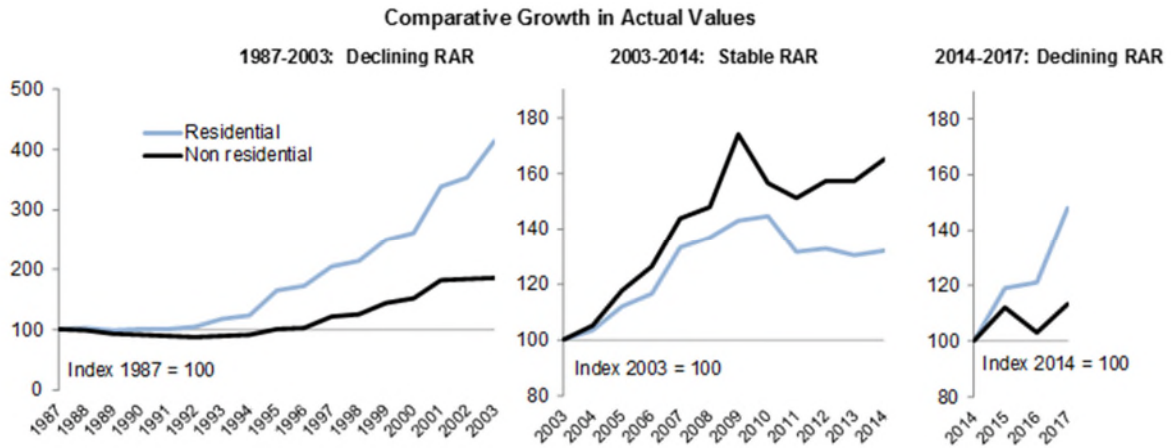
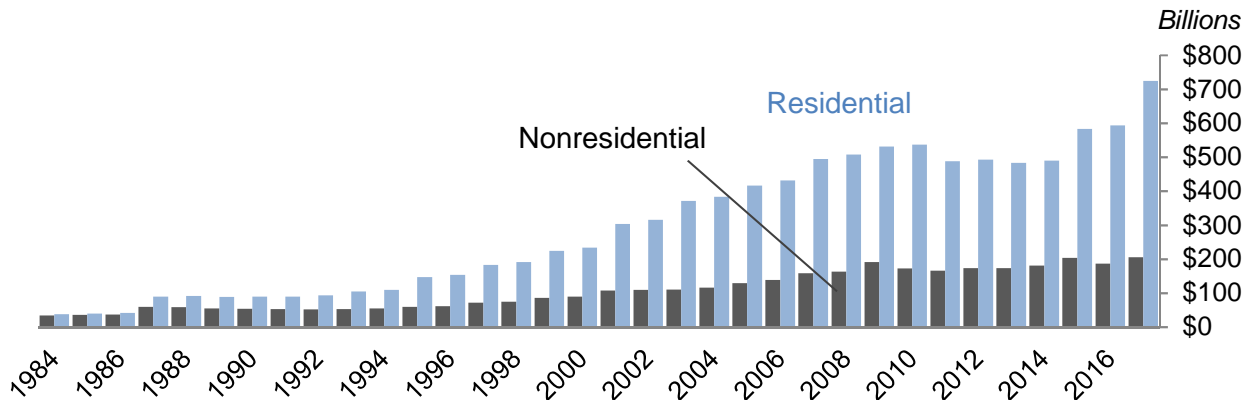
If the value of residential property were to grow faster than the value of non-residential property, the ratio in Figure 4 would shift so that the market value of residential property would be greater than 75 percent of the total. That would mean that the residential assessment rate would need to become smaller because the value of residential property would need to shrink even more to produce the required 45 percent.

If the value of residential property were to grow slower than the value of non-residential property, the ratio in Figure 4 would shift so that the market value of residential property would be smaller than 75 percent of the total. In this case, the residential portion would still need to shrink, but not by as much as before. Thus, the residential assessment rate would be larger. It would remain smaller than the non-residential rate, but it would be larger than it was before. Since 1992, TABOR has prevented this from happening because it requires a statewide vote to increase an assessment rate.

Figure 5 presents four graphs comparing residential and nonresidential market values in Colorado. The top graph depicts aggregate residential and nonresidential actual values from 1984 through 2017. The bottom three graphs compare growth in residential and nonresidential values during three separate periods, first from 1987 through 2003, next from 2003 through 2014 and finally from 2014 through 2017. In each case, values are indexed to the first year of the period to demonstrate how the values diverged over the course of the period.

Declining RAR from 1986 to 2003. From the passage of the Gallagher Amendment through 2003, actual values for residential real property grew at a faster rate than those of nonresidential property. Between 1986 (prior to the first change in the residential assessment rate under the Gallagher Amendment) and 2003, the actual value of residential property grew more than twice as fast as the actual value for nonresidential property. The value of residential property climbed from \$41.2 billion to \$371.1 billion, or an average of 12.9 percent annually, while nonresidential actual values increased from \$36.4 billion to \$110.0 billion, or 6.5 percent per year.

**Figure 5
Residential and Nonresidential Actual Values**



Source: Colorado Division of Property Taxation, Department of Local Affairs.

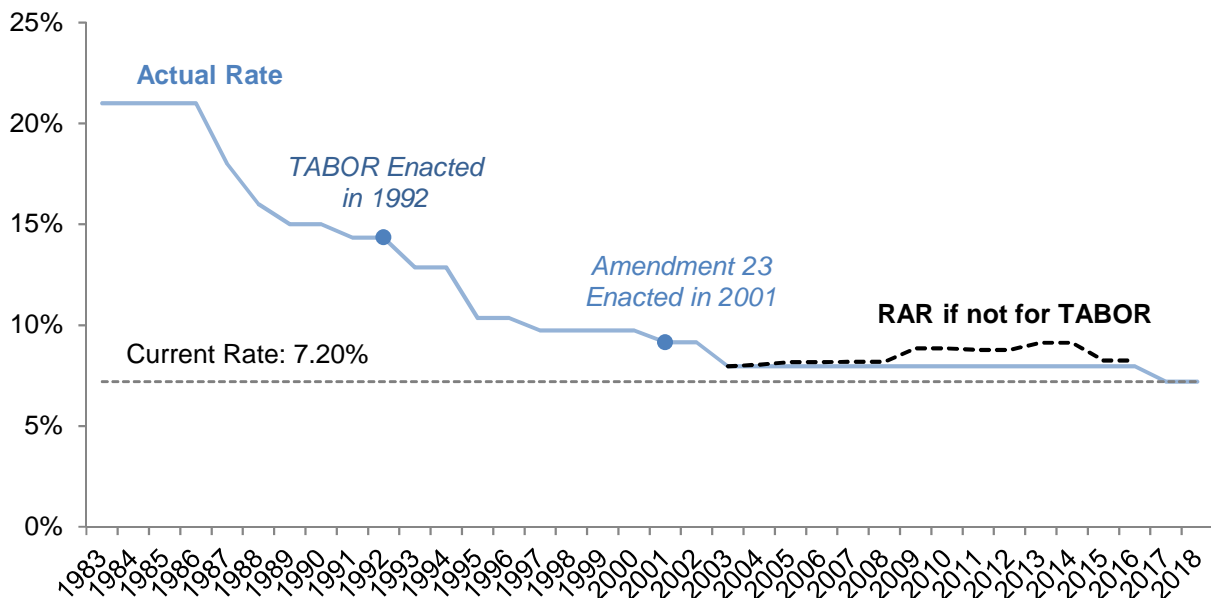
Stable RAR from 2003 to 2014. From 2003 to 2014, the growth in residential actual values slowed and this trend reversed: nonresidential actual values averaged 4.6 percent annual growth, while residential values averaged 2.5 percent annual growth. In the final period from 2014 to 2017, the trend reversed again, as residential values grew more than three times as fast as nonresidential values on an average annual basis. Residential actual values averaged 13.0 percent annual growth, while nonresidential values averaged 4.1 percent annual growth over this three-year period. The bottom three figures clearly show that residential values grew more rapidly until 2003, nonresidential values grew more rapidly from 2003 to 2014, and residential values have grown more rapidly from 2014 through 2017.

Figure 6 shows the actual residential assessment rate since the passage of the Gallagher Amendment. As a result of this amendment, the rate declined steadily, from 21 percent in 1983 to 7.96 percent in 2003 where it remained through 2017, before falling again to 7.20 percent. The decline occurred because, until 2003, the value of residential property grew faster than the value of nonresidential property. However, from 2003 through 2014, the value of nonresidential property increased faster than the value of residential property, meaning that the residential assessment rate would have been adjusted upward had TABOR not been enacted in 1992. The dotted line indicates the upward

adjustments to the 7.96 percent residential assessment rate that would have occurred in the absence of TABOR. For example, for 2015 and 2016, the rate would have been set at 8.24 percent in the absence of TABOR.

Declining RAR beginning in 2014. Faster growth in residential values once again began to place downward pressure on the RAR beginning in 2014. This pressure ultimately caused the RAR to drop to 7.2 percent in 2017, and is currently projected to cause further declines in the future.⁴

**Figure 6
Residential Assessment Rates**



Sources: Colorado Division of Property Taxation, Department of Local Affairs; Legislative Council Staff.

Uniform mill levies and the increase in state share. The Gallagher Amendment increased the need for state aid for school finance by limiting the ability of school districts to increase property tax revenue. From 1983 until 1992, as the residential assessment rate declined, the revenue loss was somewhat offset through an increase in the school finance mill levy. After enactment of the 1988 School Finance Act, school districts generally had to impose a uniform mill levy that was set each year by the General Assembly. Although most districts imposed the same levy, the General Assembly used a variety of methods to determine the levy.

Prior to passage of TABOR, the General Assembly could offset the reduction in the property tax base by establishing targets for the aggregate state and local contributions for school finance and adjusting school district mill levies to achieve those targets. In various years, the Colorado Department of Education (CDE) was directed to set the levy to raise a dollar amount of property taxes set by law or to target a specified percentage state share. In one year, the General Assembly put the mill levy in statute. However, the uniform mill levy could only be increased such that property tax collections rose by no more than 5.5 percent over the prior year's collections, although this limit could be exceeded

⁴Legislative Council Staff, December 2017 Assessed Values forecast.

under certain circumstances.⁵ Restricting school districts' tax base, combined with a limit on the amount their mill levy could increase, necessarily meant that the state picked up an increasing share of the costs for school finance.

TABOR Amendment. Approved by voters in 1992, the TABOR amendment contains several provisions that affect the operational funding of school districts. The following are the most pertinent elements:

- TABOR limits the amount of revenue that can be collected and retained by school districts in a given year. The limit is equal to the prior year's revenue increased by inflation plus student enrollment growth; and
- TABOR requires voter approval for an increase in a district's mill levy or an increase in the assessment rate for any class of property, including residential property.

TABOR thus directly affects public school funding by limiting the amount of revenue that a school district can retain and spend. Districts that exceed this limit must refund any revenue collected over the limit to local taxpayers, unless they receive voter approval to keep the amount over the limit. Because state aid is counted as TABOR revenue for a school district and this revenue has often grown faster than inflation plus enrollment growth, all but four of the 178 school districts have sought and received voter approval to retain additional revenue above the limit.

While most school districts have received approval to keep revenue above their TABOR limit, the General Assembly has incorporated the TABOR provision that school district property taxes can only increase by inflation plus enrollment growth into the statutory language of the Act. When property tax revenue exceeded this limit, a school district had to reduce its mill levy to keep property tax revenue within this limit. This decline in mill levies caused school district revenue to "ratchet down" whenever the growth in property values was too high to keep school finance property tax revenue within the TABOR limit. When school district mill levies decrease, they cannot later be increased without voter approval.

Impact on individual school districts. TABOR also shifts the school funding burden in the Act away from local sources and toward state aid. This shift occurs due to a variety of assessed value changes that occur across the state's diverse 178 school districts over time for a variety of reasons. An analysis of the circumstances for two individual districts with very different drivers is described below.

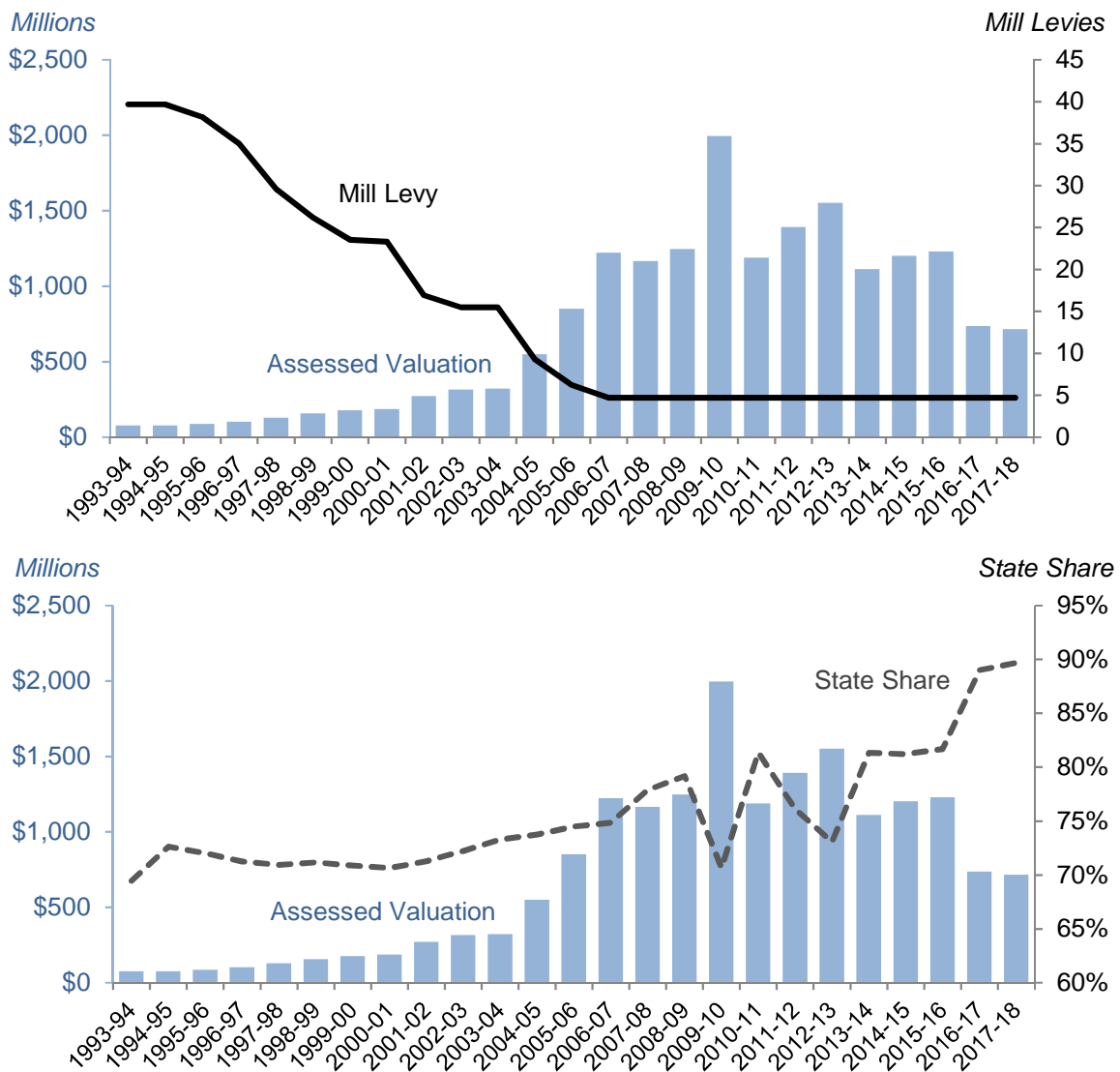
The first example is Rifle School District, a small district in Garfield County with a large amount of oil and gas production in its property tax base. The county lies within the Piceance Basin, where historically, a large proportion of Colorado's natural gas production has occurred. Production often fluctuates significantly over time due to price fluctuations and other market impacts. In years with increasing prices and production, district assessed values will rise correspondingly, and the district's mill levy must be reduced to comply with the TABOR Amendment's property tax limit. Conversely, in years when prices and production decline and assessed values decrease, the mill levy cannot be

⁵Section 29-1-301, *et seq.*, C.R.S. This statutory provision is not part of the Gallagher Amendment.

increased unless voters in the district approve a higher levy. Because state aid makes up for the reduction in local revenue, once the mill levy is reduced, it is effectively “ratcheted down” indefinitely.

Figure 7 graphically illustrates the impact of rising assessed values and declining district mill levies for the Rifle School District. When TABOR was enacted, the district’s levy was 39.689 mills on nearly \$76 million in assessed value. At that time, the district received 69 percent of its funding from state aid and 31 percent from local sources. As assessed values rose with rising energy prices and increasing natural gas production, the district’s mill levy declined, reaching its current level of 4.7 mills in FY 2006-07. The top panel of Figure 7 displays the mill levy decline that resulted from the increase in assessed value.

Figure 7
Assessed Values, School Finance Mill Levies and the Impact on the State Share for the Rifle School District

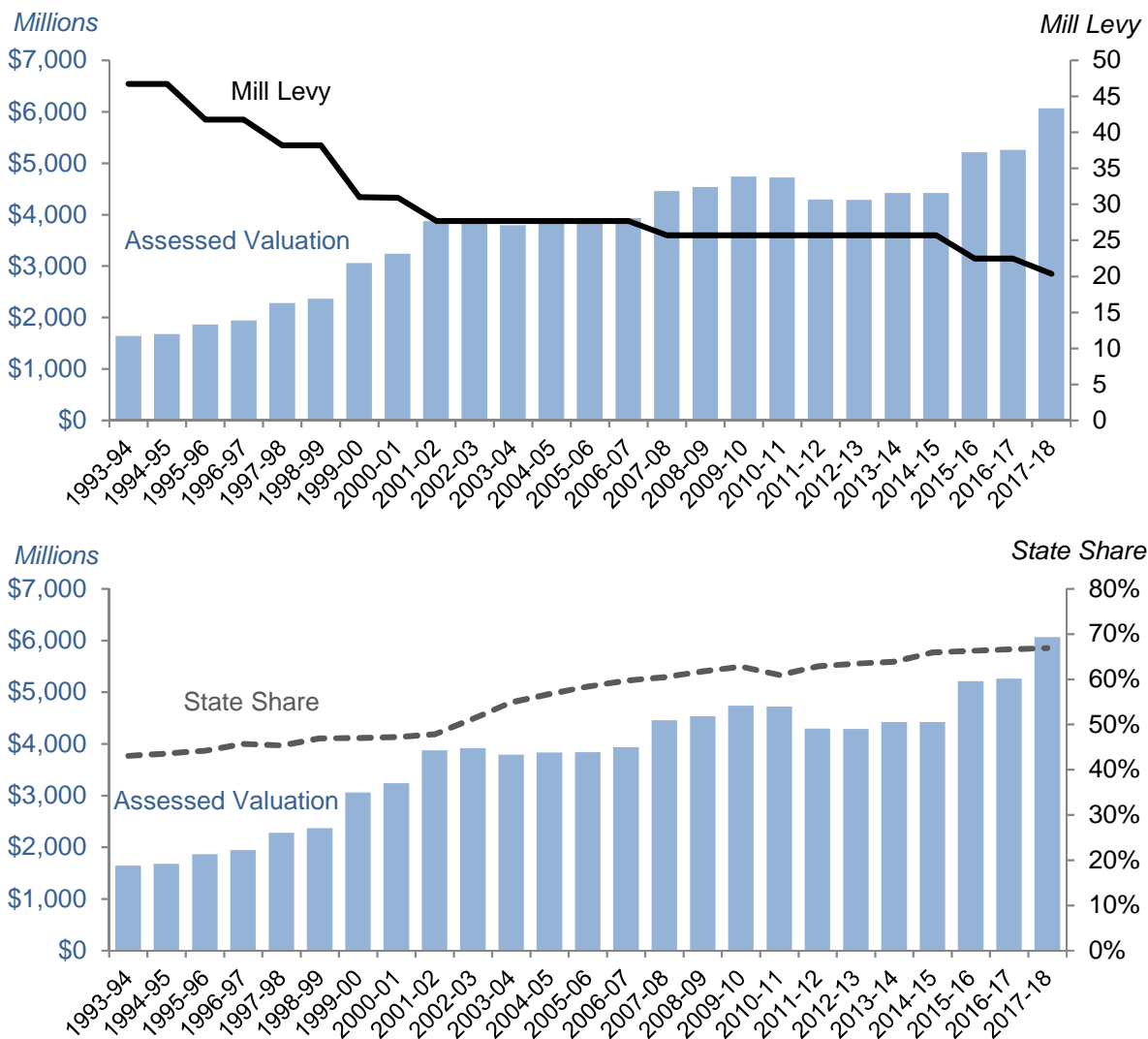


Source: Legislative Council Staff.

As the bottom panel of Figure 7 shows, the district’s percentage of state funding generally increased from FY 1993-94 through FY 2017-18. The exceptions to this trend occurred in FY 2009-10, FY 2011-12, and FY 2012-13, when assessed values rose enough to cause a drop in the district’s state share. Over the entire period, the declining mill levy has resulted in the state share increasing from 69 percent to 90 percent, despite an increase in local assessed values of nearly 1,000 percent over the same period.⁶

The second example, the Cherry Creek School District, is a large suburban district in the Denver metro area with a high proportion of residential value in its property tax base. As residential values appreciate and district assessed values rise, the district’s mill levy is similarly “ratcheted down”, shifting an increasing share of the school funding burden to the state.

Figure 8
Assessed Values, School Finance Mill Levies and the Impact on the State Share
For the Cherry Creek School District



Source: Legislative Council Staff.

⁶The increase in assessed values in FY 2009-10, FY 2011-12, and FY 2012-13 did not cause a mill levy reduction because of a provision in Senate Bill 07-199 that is described later in this memorandum.

Figure 8 graphically illustrates the impact of rising assessed values and declining district mill levies for the Cherry Creek school district. When TABOR was enacted, the district's levy was 46.738 mills on \$1.6 billion in assessed value. At that time, the district received 43 percent of its funding from state aid and 57 percent from local sources. As the figure shows, while assessed values have generally risen over the last 24 years with the appreciation of the residential real estate market, the district's declining mill levy has resulted in an ever increasing reliance on state aid. In FY 2017-18, the percentage of Cherry Creek's school funding from the state was almost 67 percent.

While similar patterns may be seen in several of the larger urban districts that rely on residential property values, Cherry Creek is somewhat unusual in that it is one of four school districts statewide that has not exempted itself from the requirements of the TABOR Amendment through a vote of the people. Thus, Cherry Creek's mill levy was one of the few that declined in FY 2017-18, falling to 20.359 mills while its proportion of state funding reached an all-time high.

Interactions with the Gallaher Amendment. Besides affecting school finance funding, TABOR interacts with the Gallaher Amendment to increase the state share of K-12 education funding over what it would have been otherwise. In the years before 2003, when the residential assessment rate remained constant or decreased due to the Gallaher Amendment, the school district property tax base would fall. Because TABOR prohibits mill levy increases without voter approval, school district property tax revenue grew more slowly than it otherwise would have, reducing the money available for the local share of school finance. Since the state was required to make up the difference, the local share of school funding fell while the share covered by state aid rose.

Under TABOR, just as with mill levies, movement in the residential assessment rate is asymmetric — it can only decrease and may not increase without voter approval. In the years since 2003 when the residential assessment rate would have risen under the Gallaher Amendment alone, TABOR required that the rate remain unchanged at 7.96 percent. Thus, in years when school district property tax revenue would have risen and state aid would have declined, TABOR prevented this from occurring. TABOR thus works to increase the state share for public education over what it would have been otherwise.

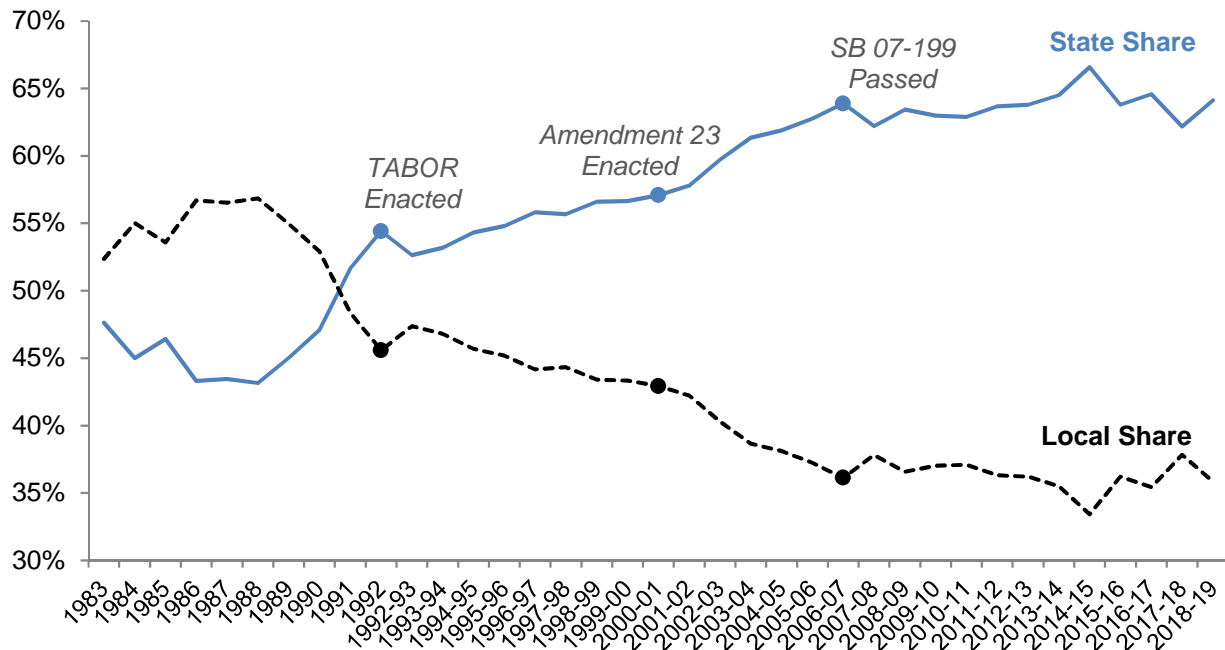
Amendment 23. Approved by voters in 2000, Amendment 23 was designed to increase public education funding in Colorado. The amendment includes the following specific provisions that affect the Act:

- it requires that the statewide base per pupil funding and total funding for categorical programs be increased by at least the rate of inflation, and by at least inflation plus 1 percent for the first ten years through FY 2010-11;
- it created the State Education Fund, and transfers to the fund an amount equivalent to one-third of one percent of federal taxable income from the General Fund. This revenue is exempt from TABOR limitations; and
- through FY 2010-11, it included a maintenance of effort provision that required the state's General Fund contribution to increase by a minimum of 5 percent annually if personal income in the state grew by at least 4.5 percent.

The passage of Amendment 23 reduced the General Assembly's flexibility with school finance since it required guaranteed minimum increases. The amendment essentially required growth in education funding to outstrip the growth allowable for the local share. Through FY 2010-11, the minimum increase was inflation, plus enrollment growth, plus 1 percent. This minimum increase exceeded the maximum allowable increase in school district property taxes by one percentage point. For those districts with property tax revenues below the allowable limit, the gap in these growth rates was even greater. Amendment 23 thus increased the pressure on the state to cover a growing share of the cost of K-12 public education.

Figure 9 graphically depicts the change in the local and state shares of school finance since the passage of the Gallagher Amendment. From 1983 until 1991, local school districts covered the majority of the costs of public education in Colorado. After passage of TABOR in 1992, the state share continued to increase while the local share declined. As Figure 8 shows this pattern accelerated after passage of Amendment 23 in 2001, but has stabilized with the passage of Senate Bill 07-199 in 2007, which prevented mill levies from falling for most school districts in the state.

Figure 9
Relative State and Local Shares of School Finance

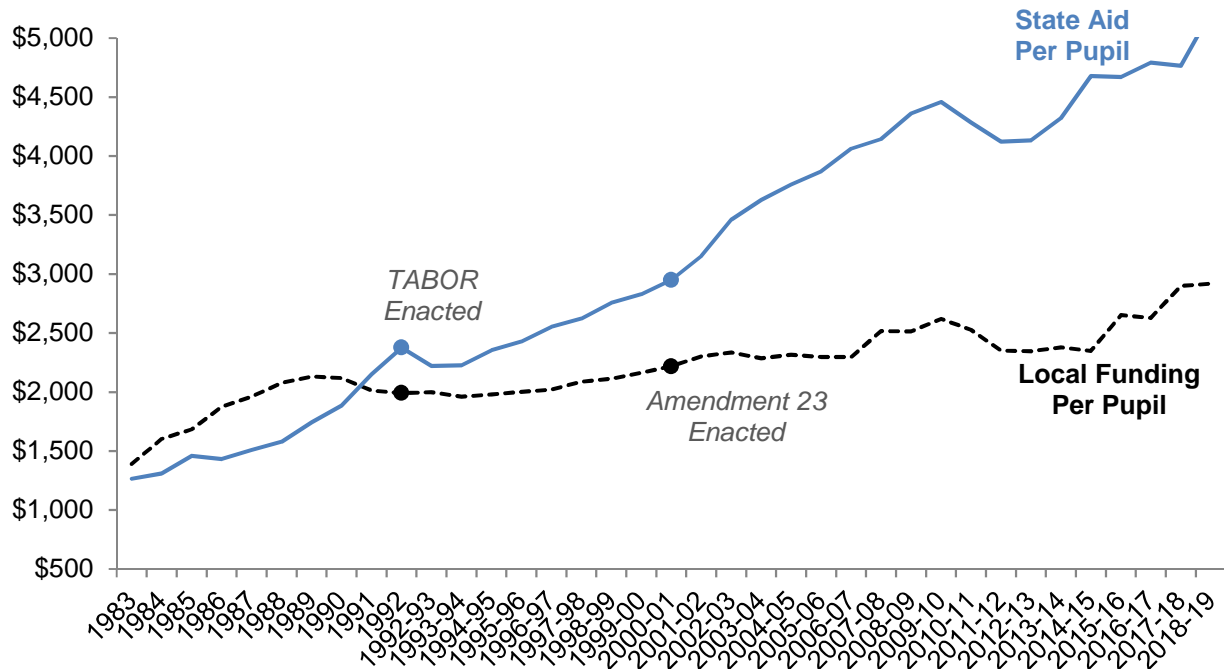


Source: Legislative Council Staff.
Note: Prior to 1993, K-12 funding was done on a calendar year basis.

The accelerated growth in the state share for school finance can also be shown on a per pupil basis. Figure 10 presents the change in both state aid and local property taxes, on a per pupil basis, from 1983 through FY 2018-19. The figure shows the points in time when the various constitutional amendments became effective. Prior to passage of TABOR, the legislature made an effort to increase the state share, and state aid per pupil surpassed the per pupil local share in 1991. After the passage of TABOR, the legislature lost the ability to control the local share of school finance. Through the rest of the 1990s, per pupil state aid continued to increase while the local share remained relatively

constant. After the passage of Amendment 23, state aid increased at an even faster rate while the local share remained steady. The per pupil local share finally jumped in FY 2007-08 with the passage of Senate Bill 07-199. From FY 2010-11 through FY 2014-15, the local share remained relatively constant, but the state share has increased due to the General Assembly's efforts to reduce the budget cuts associated with the budget stabilization factor. With the rapid increase in assessed values since 2014, the local share has increased more rapidly than the state share, even with the fall of the RAR in the 2017 and 2018 property tax years.

Figure 10
State Aid and Local Funding Per Pupil



Source: Legislative Council Staff.

The Legislature's Response to Constraints on School Funding

The General Assembly has responded to both the impacts of interacting constitutional constraints and funding limitations that resulted from the recent recession. First, the relative growth in the state share of K-12 public education funding caused by the interacting requirements of the three constitutional amendments was addressed through the passage Senate Bill 07-199. This bill contained provisions that stabilized mill levies on property taxes for school districts that had received voter approval to retain revenue above their TABOR limit. House Bill 10-1369 added the budget stabilization factor to the school finance formula. This factor reduced the state's share of school funding and established that total program will be budgeted to a targeted level determined by the General Assembly.

Senate Bill 07-199. When the Act was initially passed in 1994, school districts provided about 46.8 percent of public school funding, and the state provided the remaining 53.2 percent. Between FY 1993-94 and FY 2006-07, the state's share of school funding increased to 63.9 percent, while the local share decreased to 36.1 percent.

The issue of the increased state share was addressed through provisions contained in Senate Bill 07-199, which made two specific changes to the method of calculating school district mill levies. First, school district mill levies were capped at 27 mills. For districts with a levy greater than 27 mills, the bill reduced tax rates and district property tax revenue. Second, the bill required districts that had received voter approval to retain revenue above their TABOR limit to impose the prior year's mill levy. For these districts, this provision effectively "froze" mill levies at FY 2006-07 levels. Mill levies could only decline for districts where assessed values increased sufficiently such that, at existing mill levies, collections would exceed a district's total program and categorical buyout. Figure 8 graphically shows the effect of this change on the relative state and local shares of public school funding. Beginning in FY 2007-08, the education funding provided by local districts initially increased, and then stabilized between 36 and 37 percent through FY 2013-14. In FY 2014-15, the state share increased as the General Assembly attempted to reduce the budget cuts associated with the negative factor. During the last two fiscal years, the local share has stabilized at about 36 percent.

Figure 11 presents the annual impact of Senate Bill 07-199 on local property tax revenue from FY 2007-08 through FY 2018-19. These amounts reflect the additional property tax revenue contributed to K-12 public education relative to what would have been contributed without the bill.

Figure 11
Estimated Impact of Property Tax Changes from Senate Bill 07-199
Dollars in Millions

Fiscal Year	Annual Impact
FY 2007-08	\$115.6
FY 2008-09	127.3
FY 2009-10	202.2
FY 2010-11	202.2
FY 2011-12	198.9
FY 2012-13	213.2
FY 2013-14	223.4
FY 2014-15	241.8
FY 2015-16	455.0
FY 2016-17	436.6
FY 2017-18	626.5
FY 2018-19*	632.9
Total	\$3,675.6

Source: Legislative Council Staff.

The Mesa County Commissioners brought a lawsuit challenging the provisions of Senate Bill 07-199 that affected property tax mill levies.⁷ The Colorado Supreme Court upheld the bill's constitutionality.

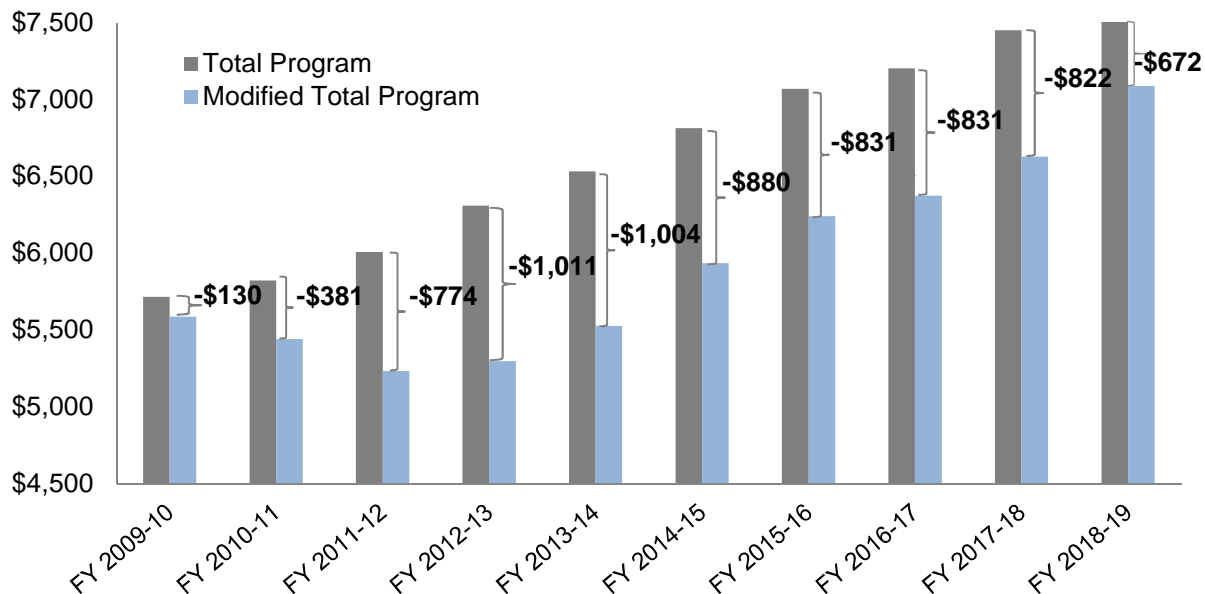
House Bill 10-1369. As a result of the 2008 recession, the General Assembly struggled to reconcile lower state revenues with the constitutional requirement for ever-increasing base per-pupil funding for K-12 public education. In the 2010 legislative session, the legislature rescinded \$130 million in

⁷*Board of County Commissioners of Mesa County v. Ritter, (Colo. 2009).*

public education funding for FY 2009-10. In House Bill 10-1369, the legislature introduced the budget stabilization factor, designed to further reduce the state's share of public education funding. The factor is applied after all other calculations in the formula, and reduces total program funding for most school districts by a fixed percentage. Districts that do not receive enough state aid to fully implement this funding reduction must instead offset state spending on categorical programs in their district with local funding to the degree possible. Because funding reductions come from the additional moneys contributed by the other factors, the budget stabilization factor does not affect base funding. Imposition of the budget stabilization factor functionally changes the role that state aid plays in the context of school finance. Instead of letting total program be formula-driven with state aid covering whatever gap exists between total program and the local share, the budget stabilization factor allows the General Assembly to determine the funding level it can afford and budget the state's overall contribution to school finance.

Figure 12 graphically compares the K-12 funding level derived from the school finance formula (without the budget stabilization factor) to the actual level that occurred. In FY 2009-10, before the imposition of the budget stabilization factor, \$130 million in state aid originally appropriated was rescinded through a negative supplemental appropriation. In FY 2010-11, the General Assembly set the negative factor at 6.6 percent of total program funding, representing a cut of \$381 million from the funding level without the factor. In FY 2011-12, the funding reduction was 13.0 percent of total program funding, or \$774 million less than the funding level without the factor. In FY 2012-13, the funding reduction was 16.1 percent of total program funding, or \$1.0 billion less than the funding level without the factor. On a year-over-year basis, the reduction in school district funding after application of the budget stabilization factor in FY 2010-11 and FY 2011-12 was \$145 million and \$210 million respectively. In FY 2012-13, school district funding after the budget stabilization factor increased by \$66 million from the prior year, and has continued to increase every year since then. In FY 2018-19, school district funding after application of the negative factor increased by \$460.9 million on a year-over-year basis.

Figure 12
Budget Reductions from Rescissions and the Negative Factor
Dollars in Millions

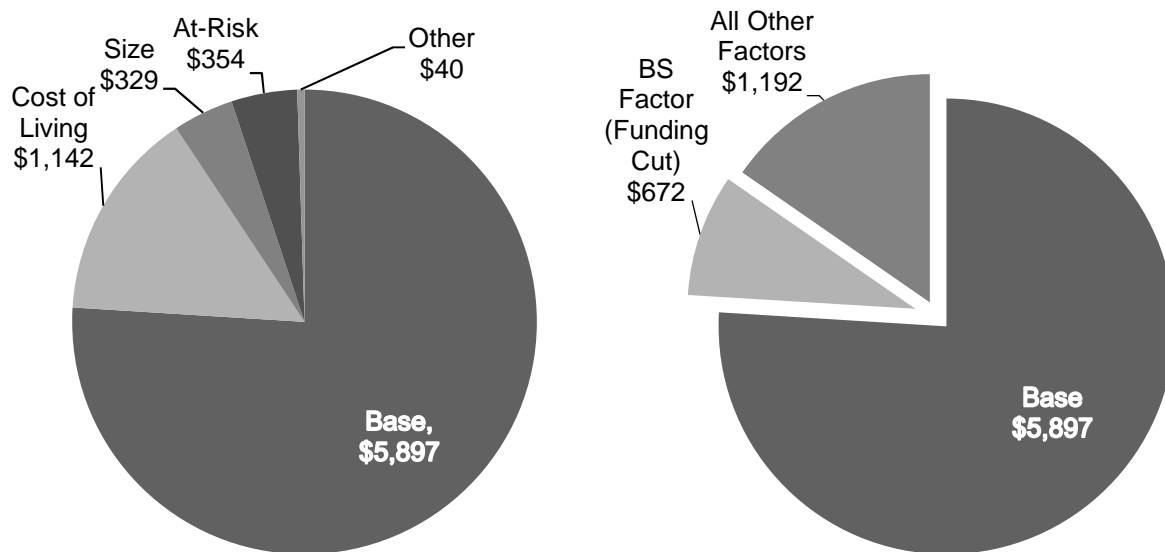


Source: Colorado Department of Education, Legislative Council Staff.

While the budget stabilization factor implements proportional reductions across districts, its actual impact can vary depending on the amount of state aid that a district receives. During each year that this factor has been in place, there have been some districts that do not receive enough state aid to fully implement the funding reduction. These districts are required to reimburse the state for a portion of the funding they receive for categorical programs. In FY 2018-19, one school district (Cripple Creek) could not fully implement the proportional cuts from the budget stabilization factor and was required to reimburse a total of nearly \$55,000 in categorical program funding.

The budget stabilization factor has relieved budgetary pressure in the short run, but it is limited in terms of its overall size. It can only be as large as total non-base per-pupil funding. Figure 13 presents two pie charts that graphically depict the impact of this factor on FY 2018-19 school finance funding. The chart on the left shows the contributions to total program made by base funding and each of the additional factors in the school finance formula, before the negative factor is applied. The chart on the right shows that the application of the budget stabilization factor absorbs a little more than one-third of the funding contributed by the other factors.

Figure 13
School Finance Funding Elements, FY 2018-19
Millions of Dollars



Source: Legislative Council Staff.

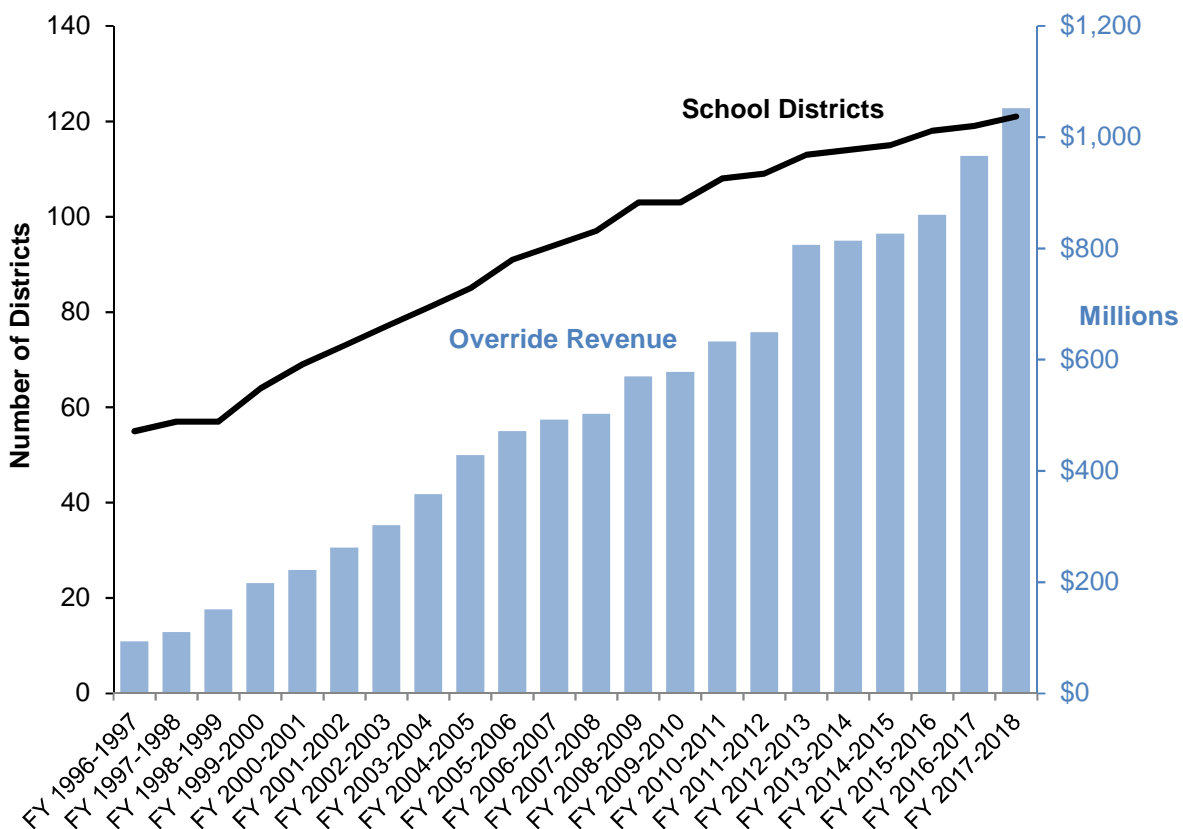
In FY 2018-19, the General Assembly set the budget stabilization factor at 8.66 percent of total program thereby reducing funding by \$672 million. The General Assembly also specified that in FY 2019-20, the budget stabilization factor could not exceed FY 2018-19 levels. A budget stabilization factor of \$672 million in FY 2019-20 implies an 8.36 percent reduction in total program given projected enrollment and inflation changes.

School District's Response to Constraints on School Funding

School districts have, in turn, responded to both the impacts of interacting constitutional constraints and the funding limitations resulting from the recent recession with the passage of mill levy overrides. A mill levy override is a voter-approved addition to the number of mills levied by a school district. Mill levy overrides provide additional operating revenue exclusively for the school district. Overrides are in addition to the normal school finance mill levy, and are thus not included in the calculation of the local share within the Act. Under state law, override revenue for each district is capped at the greater of 25 percent of total program funding or \$200,000 for larger districts and the greater of 30 percent or \$200,000 for small rural districts. Override revenue may not be used to pay for capital construction or renovation projects.

How has the use of overrides changed over time? The use of mill levy overrides was initially authorized in state statute for FY 1994-95. The first overrides were approved by voters in FY 1996-97 when authorized overrides in 55 school districts generated over \$93 million in additional property tax revenue for those districts. Over the last 23 years, both the number of school districts seeking override authorization and total override revenue has grown substantially. In FY 2017-18, 121 school districts had authorized overrides, generating nearly \$1.1 billion in additional operating revenue. Figure 14 graphically presents the change in both the number of districts with overrides and the total revenue generated over this period.

Figure 14
Number of School Districts with Overrides and Override Revenue



Source: Colorado Department of Education.

As Figure 14 shows, while there has been a steady increase in revenue generated through overrides during this period, override revenue increases in some years more than other. For example, while total override revenue increased discernably in both FY 2008-09 and FY 2010-11, it made a relatively large jump in FY 2012-13, increasing from \$650 million to nearly \$810 million. The timing of this jump likely represents a response by school districts to the legislature's implementation of the budget stabilization factor in FY 2010-11.

Since FY 2011-12, many school districts have used mill levy overrides to replace the operational funding lost through implementation of the budget stabilization factor. Using a measure of net override revenue for each district, defined as district override revenue net of district budget stabilization factor reduction, 62 districts had positive totals in FY 2017-18. In other words, override revenue exceeded the reduction in funding from the budget stabilization factor. Of these districts, eight had more than \$10 million in net override revenue, with totals ranging as high as \$122 million. Conversely, 59 districts had negative net override revenue totals, because the amounts authorized were not enough to offset the budget stabilization factor funding reductions.

The ability to replace budget stabilization factor funding reductions with local override revenue varies widely across school districts, and depends on a variety of factors, including district property wealth and the current level of the district's total program mill levy. For example, all eight districts with greater than \$10 million in net override revenue in FY 2017-18 are located along the Front Range and have high property tax bases. All eight have also authorized overrides of at least 62 percent of their override limit. Four of the eight have override revenue above their limit due to an allowable cost of living adjustment. Boulder voters have authorized continuous override increases up to 100 percent of its limit.

Several other districts, however, have lower net override levels, despite being at or near their override limit. For example, Aspen voters have also authorized a continuous override increase in order to generate the maximum allowable override revenue, but are limited by their district size. Eleven other districts with positive net override revenue are over 90 percent of their applicable limits, and thus have little ability to authorize additional overrides.

Finally, as of FY 2017-18, 57 districts had not authorized any mill levy overrides. This may be because the district had never asked its voters to approve an override or because the voters declined to authorize an override. Districts with relatively low property wealth are limited as the mill levy required to generate significant revenue can be prohibitively high.