Local Government Snapshot

NEW YORK STATE OFFICE OF THE STATE COMPTROLLER

Thomas P. DiNapoli • State Comptroller

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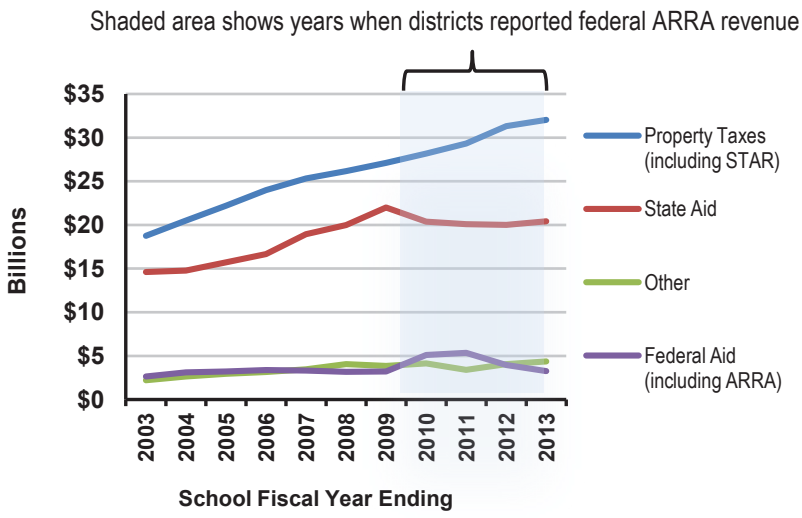
Revenue Challenges Facing School Districts

School districts are facing a set of unique fiscal challenges that have left many tightening their belts even as the economic recovery has begun to improve New York State finances. Reductions in State aid for school years 2009-10 and 2010-11 in the wake of the Great Recession were largely offset by billions of dollars in temporary federal aid, but the vast majority of those federal funds were exhausted within two years.[1] Moreover, recent State aid increases have not made up the difference, leaving schools with less total State and federal funding in 2012-13 than in 2009-10. Aid reductions have particularly affected high-need districts and their students. The timing of the recession also disrupted the implementation of a major State aid overhaul aimed at simplifying aid formulas and driving additional aid to high-need districts. Districts must also contend with the challenges imposed by caps to future State aid and property tax levy growth, as well as limitations on their "rainy day" funds. The combination of these factors has left many districts in some level of fiscal stress.

School District Revenues by Source

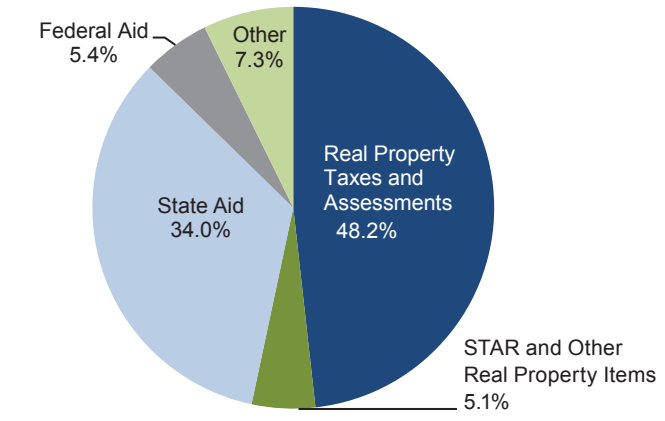


Source: New York State Office of the State Comptroller (OSC)

- In 2012-13, school district revenues totaled $60.1 billion.[2] Of that total, just over half came from real property taxes and School Tax Relief (STAR) reimbursements. State aid to schools accounted for 34 percent. Federal aid accounted for 5 percent, down from a peak of 9 percent in 2010-11.

- From 2007-08 to 2012-13, total school district revenues grew by an average rate of 2.4 percent per year. Although this was greater than inflation during the period, which averaged 1.8 percent per year, it was considerably slower than the average 6.9 percent total revenue growth annually from 2002-03 through 2007-08, when a healthy economy, rising property values and the start of a major new State aid initiative all contributed to large increases each year.

School District Revenues by Source, 2012-13 School Year Total Revenues: $60.1 Billion



Source: OSC

State and Federal Aid

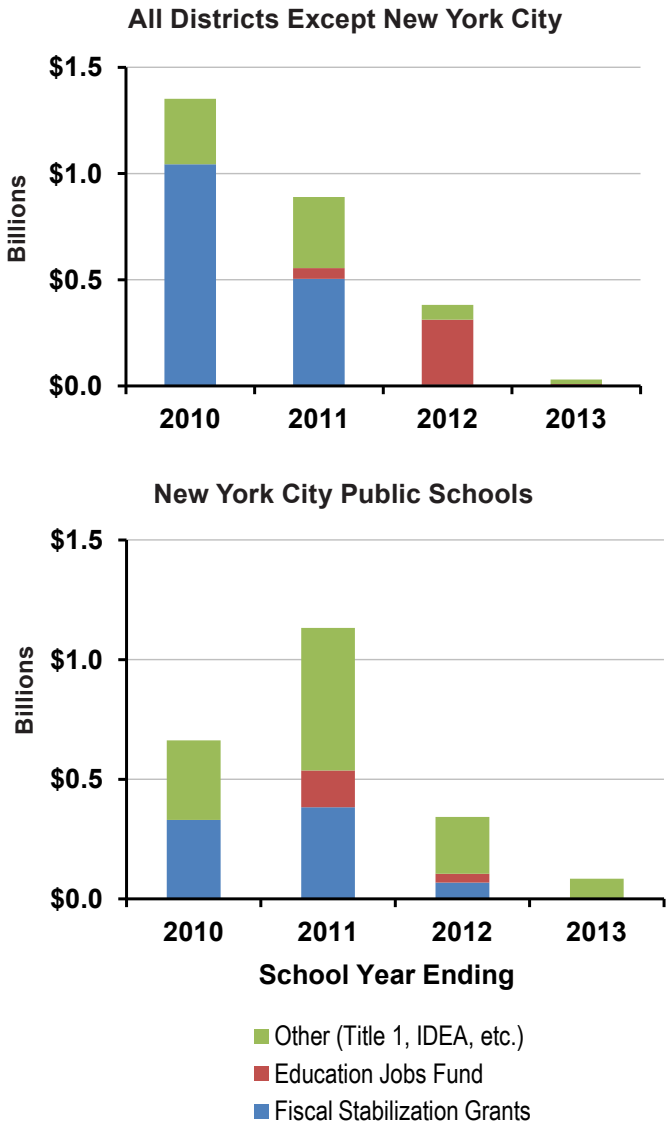
- Faced with the prospect of a major deficit in its 2009-10 fiscal year, the State substantially reduced aid to schools, and prospects looked grim for future year funding as well. State school aid reductions were partially and temporarily offset, however, by funding from the federal American Recovery and Reinvestment Act (ARRA).

- Some of the ARRA funding was distributed by the State, as part of its own school aid package, directly offsetting State cutbacks. The largest portion of this funding was $2.3 billion in ARRA Fiscal Stabilization grants that the State used mostly in school years 2009-10 and 2010-11. The State chose to distribute most of this funding in 2009-10, due to budget shortfalls, and most of it went to districts outside New York City. At the last minute in the 2010-11 budget process, the State was also able to award another $558.7 million in Education Jobs (Ed Jobs) funds for use in school years 2010-11 and 2011-12.

- The federal government also increased direct aid to high-need districts, especially New York City, over several years. This funding included aid for specific student populations, including students in poverty and disabled students, as well as technology funding.[3]

- Even with Fiscal Stabilization grants and Ed Jobs funds added in, school aid funding dropped by nearly 10 percent between 2009-10 and 2011-12, and the total amount of school aid appropriated in 2011-12 was $8 billion (29 percent) lower than the level that had been projected for that year in the 2008-09 budget.

American Recovery and Reinvestment Act (ARRA) Funding for School Districts

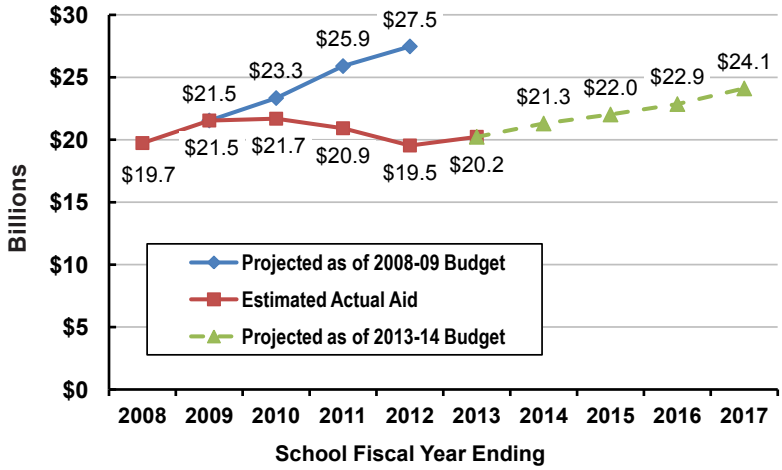


Source: New York State Education Department (SED); figures do not include "Race to the Top" funds.

- A cap on future growth in school aid was built into the 2011-12 State budget. The cap was tied to growth in New York State personal income, one measure of taxpayers' ability to afford aid increases, although the 2013-14 enacted budget did contain a "one time" increase in aid greater than that amount.[4] According to that year's financial plan, school aid will likely not reach school year 2009-10 levels again until school year 2014-15.

- In addition to their total dollar impact, the school aid reductions came at a critical time for State school aid distribution. The 2007-08 budget contained a new Foundation Aid formula, which was intended to provide adequate funding for a "sound basic education" in all districts.[5] Based on a calculation that took into account factors affecting both cost (such as total enrollment, poverty and limited English proficiency) and the ability to pay locally (property value and income), this formula was to be phased in over four years. Since there was no plan to reduce aid already distributed to districts with lower need or higher wealth, the later years of the phase-in would have been especially favorable to districts previously underfunded by the formula. Due to recessionary budget constraints, however, Foundation Aid was not fully phased in. Instead, it remained frozen at 2008-09 levels, irrespective of subsequent changes to the factors that drive costs or a school district's ability to pay. Consequently, high-need districts – which would have received the largest increases under this formula – have been most affected by the stagnation in aid.

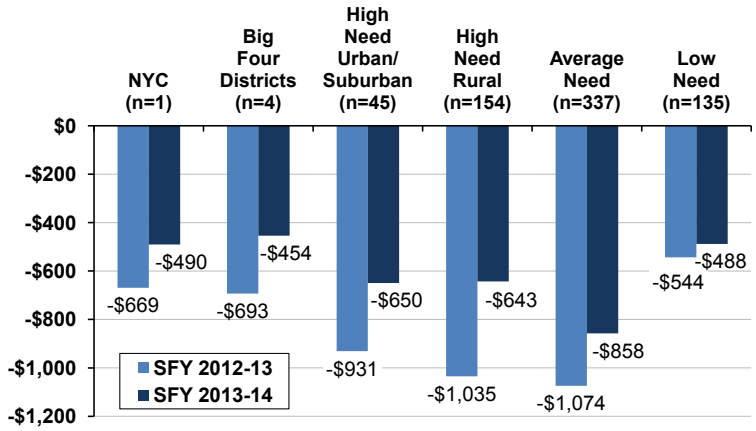
Comparison of Projected and Actual School Aid
(includes ARRA Fiscal Stabilization and Ed Jobs funds)



Source: New York State Division of the Budget (DOB). The "Projected as of" numbers are from the Mid-Year Update to the Financial Plan (2008-09 and 2013-14); the "Estimated Actual Aid" is from Description of New York State School Aids (2008-09 to 2013-14), Table II-A.

- In addition to freezing Foundation Aid, the State implemented a gap elimination adjustment (GEA). After calculating the school aid due to each district, the State would then reduce that amount by a certain percentage in order to help balance the budget, starting in the 2010-11 school year.[6] Although the percentage reduction was lower for high-need districts, the dollar impact on them was about the same as for average-need districts, and greater than the impact on low-need districts, because high-need districts depend more heavily on school aid.[7]

Net Gap Elimination Adjustment per Pupil for School Fiscal Years 2012-13 and 2013-14



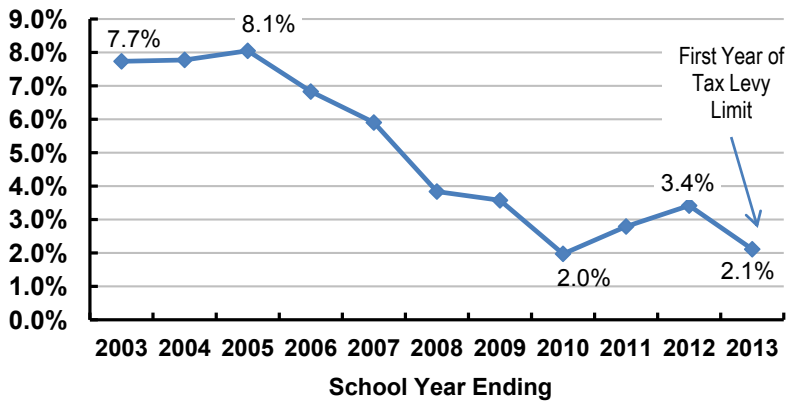
Source: DOB and OSC. The "Big Four" districts are Buffalo, Rochester, Syracuse, and Yonkers.

- In 2012-13 and 2013-14, the State was able to increase its funding for school aid, but it has neither completely eliminated the GEA nor re-established the Foundation Aid formula. Instead, these increases have been implemented through a series of complex and overlapping formulas. For example, instead of merely reducing the percentage of the GEA imposed on each district, each year's budget has treated the prior year "net GEA" as a base, and created a new formula for distributing "GEA restoration aid." In 2013-14, this calculation had ten sub-formulas. Perhaps more problematic in the long run, "increases" to Foundation Aid were implemented by multiplying the existing frozen distributions by one of several growth factors, rather than by recalculating the formula using current year data. Competitive grants have supplanted some formula-driven aids as well. This complexity has led to a lack of transparency. Each year, it becomes more difficult to return to a simpler formula without causing some districts to lose substantial funding or greatly increasing overall funding levels to mitigate the impact of the losses.

Local Revenue

- Local school district revenues come almost exclusively from property taxes (including STAR). Depending on their reliance on State and federal aid, districts' dependence on property tax varies widely: from less than 20 percent in 26 districts to over 90 percent in 24 districts. School tax levy increases have been decreasing over the past decade, averaging 2.8 percent per year in the past five years outside New York City. This is less than half the 6.5 percent per year seen in the five years prior. The pattern was similar in New York City, although it had much larger school property tax increases throughout the decade, averaging 11.1 percent per year from 2002-03 to 2007-08, and 6.2 percent from 2007-08 to 2012-13.[8]

Growth Over Prior Year in School Property Tax Levy (excludes NYC)



Source: OSC

- The statutory property tax levy limit on all local taxing entities, which took effect for school districts beginning with their 2012-13 fiscal year, constrains future property tax growth as well. Under the limit, local property tax levies cannot increase by more than 2 percent, or the rate of inflation, whichever is lower, taking into account certain exclusions and adjustments. Due to low inflation in recent months, the allowable levy growth factor for school year 2014-15 is projected to be lower than 2 percent.[9] Although both local governments and school districts may exceed the cap with a 60 percent supermajority vote, school districts must achieve this through a public budget vote, whereas local governments need only obtain a 60 percent supermajority in a vote of the governing body. Also, if a school district budget fails to pass after a second public vote on the original or a revised budget, the school district must adopt a budget containing no levy increase at all from the prior year, whereas other local governments may pass a budget that includes an increase, so long as the increase remains within the levy limit.

- Because schools cannot legally maintain an unexpended surplus of more than 4 percent of their next year's budgetary appropriations, their ability to use so-called "rainy day funds" is limited. The limitation's intent was to ensure that taxpayers were not being unfairly taxed to fund the accumulation of unnecessary fund balances. Other local governments, however, do not have this limitation.[10]

Bottom Line

- Schools are facing fiscal challenges that are not likely to dissipate in the short term. Between a tax levy limit that restricts local funding, State and federal aid cuts followed by capped growth administered in a complex and opaque manner, and a lack of other sources of funding, schools are in a period of low revenue growth.

[1] Unless otherwise noted, all years are school year basis.

[2] Except where noted, figures include New York City public schools.

[3] Other ARRA programs included increases to Title I of the Elementary and Secondary Education Act (ESEA, shown as "Title I"), the Individuals with Disabilities Education Act ("IDEA") and the Enhancing Education Through Technology program ("Ed Tech") which is part of Title II, Part D of ESEA. Not shown in the chart is $697 million in competitive Race to the Top program grants, of which $348.7 million was distributed in awards to districts.

[4] For more information on implementation of the cap in the 2013-14 enacted budget, please see OSC's budget review at: **www.osc.state.ny.us/reports/budget/2013/2013-14_enacted_budget_prelim_report.pdf.**

[5] *See Campaign for Fiscal Equity vs. The State of New York,* 8 N.Y.3d 14 (NY 2006); and Regents 2013-14 Proposal on State Aid to School Districts, The State Aid Committee, Board of Regents, State University of New York, December 6, 2012, **www.regents.nysed.gov/meetings/2012Meetings/December2012/1212saa1.pdf**.

[6] In the State's 2009-10 executive budget, this was called a "deficit reduction assessment" or DRA, but it was entirely offset with ARRA funding in that year's enacted budget. The first year where districts experienced DRA reductions (partially offset by ARRA) was 2010-11. The GEA language and formula were introduced in the 2010-11 budget, and restoration of GEA reductions and net GEA concepts appeared in the 2012-13 budget. The GEA was applied to certain types of school aid. For more analysis, see OSC's annual reports on the executive and enacted budgets: **www.osc.state.ny.us/reports/index.htm#StateBudgetReports.**

[7] The Need/Resource Capacity categories are established by the New York State Education Department to measure districts' ability to meet students' needs with local resources. The categories are based on an index comprising measures of student poverty and district wealth (including both income and property value). For more on the Need/Resource Capacity index, see the definitions available from the State Education Department at: **http://www.p12.nysed.gov/irs/accountability/2011-12/NeedResourceCapacityIndex.pdf.**

[8] New York City reports levy for school purposes and city purposes separately on the Constitutional Tax Limit form filed with OSC annually.

[9] See **http://www.osc.state.ny.us/localgov/realprop/schools.htm** for more information.

[10] See OSC Accounting Bulletin "Fund Balance Reporting and Governmental Fund Type Definitions" **http://www.osc.state.ny.us/localgov/pubs/releases/gasb54.pdf** for more information.