Summary of new school funding laws

Gov. Dennis Daugaard proposed House Bill 1182, Senate Bill 131, and Senate Bill 133, based on the recommendations of the Blue Ribbon Task Force. These three bills passed the legislature and take effect this summer. House Bill 1182 included a half-cent increase in the state sales tax, which takes effect June 1. That will fund approximately $67 million for K-12 education, $36 million for property tax relief, and $3 million for technical institutes.

New K-12 funding formula

The new funding formula, which is based on a target statewide average salary of $48,500, works as follows:

- For each district, calculate a target student-to-teacher ratio, based on a sliding scale by student enrollment (see below).
- The district's target number of teachers is calculated by dividing the district's fall enrollment by the target student-to-teacher ratio.
- The district's total instructional need is calculated by multiplying the district's target number of teachers by the statewide target for average teacher salary, and by increasing that total by 29% for benefits.
- The total instructional need is increased by 31% to cover non-instructional costs. This category includes operating costs as well as salaries and benefits of non-instructional staff, such as administrators, guidance counselors, librarians, and school nurses.
- These steps calculate the district's total need for state aid. At this point, local effort is applied against total need, with the state providing any necessary funds to achieve the total need.

The law provides the following sliding scale for the target ratio, based on enrollments:

- Less than 200 — 12 students to 1 teacher
- Between 200 and 600 — Sliding scale between 12 to 1 and 15 to 1
- Greater than 600 — 15 to 1

This sliding scale retains the same enrollment thresholds as the current small school factor, as well as the value of the small school factor.

Today, the statewide student-to-teacher ratio is approximately 14:1. If every district achieves its target ratio under the new formula, the statewide ratio would be approximately 14.48:1. This ratio does not determine class size because it considers other instructional staff, such as special education teachers.

However, the formula does not require school districts to strictly meet the target ratio or to use a certain level of funding for benefits or overhead costs. Those are merely used to calculate total need, and districts retain local control on how to use the dollars they receive. However, the law requires that the increase received in FY17 be substantially used to increase teacher salaries and benefits (see "Accountability," below).

Notably, the "benefits factor" includes sufficient funds to cover all district benefit costs, regardless of current funding source. This means that revenues currently collected by the pension levy can be considered to cover this total benefits need.

Requirements that new money go to teacher salaries and benefits

The law creates two separate requirements for use of the general fund increase in FY17. Districts must comply with both requirements.

First, a district must spend 85% of its increase in local need in FY17 on instructional salaries and benefits for certified instructional staff.

Second, a district must calculate the percentage by which its local need increases in FY17, and the district's average teacher salaries and benefits must increase by 85% of that percentage increase. (For example, if a districts local need increased by 10%, its average salaries and benefits must increase by 8.5%).

For both requirements, districts can deduct the loss of pension levy proceeds from the increase in local need. Districts are also not required to count increases in local need that result from enrollment increases.

A district that fails to comply with these requirements must will have its FY18 state aid to general education funding decreased by an amount equal to fifty percent of the new money. However, the law creates a School Finance Accountability Board that can recommend waivers for school districts who can demonstrate good cause for failing to meet the requirements.

Reserve fund caps

The law reinstates reserve fund caps, on a tiered system based on enrollment, as recommended by the Blue Ribbon Task Force.

At the time that reserve fund caps were repealed, districts were capped at 40%. That was calculated by dividing the district's June 30 fund balance by general fund expenditures. If that system were reinstated today, 68 districts would be over that limit.

In FY15, DOE began collecting monthly cash balances from districts.

The law reinstates caps as follows:

- The "percentage fund balance" will be calculated by dividing the lowest monthly cash fund balance of the previous 12 months by general fund expenditures for that year. The purpose of this mechanism is to ascertain the fund level that, over the course of a year, is never used.
- Districts caps are determined by the same three enrollment tiers as the funding formula:
  - Less than 200 40%
  - Between 200 and 600 30%
  - Greater than 600 25%
- For the purpose of selecting a tier, districts use the lowest of the current year's enrollment or the previous two years' fall enrollments. This prevents a district that is close to the line from fluctuating too frequently between tiers.
- The caps take effect for FY19, or the 2018-19 school year. There are no intermediate tiers to transition districts – it is the districts' responsibility to manage toward the caps.
- Once in effect, a district that is in excess of the cap would have its state aid reduced dollar-for-dollar. The Governor will appoint a five-member oversight board to consider requests to waive the caps in special circumstances.

Abolition of the pension levy

In the past, school districts could assess up to 0.3 mills for a pension levy. The new law merges the pension levy into the general education levy. For the coming year, each general ed levy was increased 0.233, which raises the same $19.2 million that the pension levy raised in FY15. Because each class of property paid the same pension mill levy rate, the shift to the general education levy was even across the classes. Statewide, this is revenue-neutral to taxpayers.

Merging the pension levy with the general education levy also allows the $19.2 million collected to be counted toward total need in the funding formula. The new formula also includes a benefits rate for schools that will cover these pension-related benefits costs.

Currently, districts also maintain a separate pension fund. Districts will be allowed to maintain this separate fund for five years, but then will be required to merge it into the district general fund in FY21. This gives the districts time to spend down these funds without initially counting against reserve fund caps.

Capital Outlay

The law makes four changes to the current capital outlay (CO) levy:

- Repeals the sunset of CO flexibility and makes it permanent. Broadens CO flexibility so that CO collections can be used for any general fund purpose at the current level of 45% of CO property tax revenue. It also requires that funds used for flexibility be transferred to the general fund instead of expended out of the CO fund.
- Requires that districts make annual CO requests in the form of a dollar amount, not a mill levy rate.
- Limits future growth in CO collections by capping the maximum dollar amount that can be collected to increasing annually by 3% or inflation, whichever is less, plus new construction.
    - Note that this differs from the growth cap on other levies, which are applied to the amount collected, rather than the maximum that can be collected.
    - The effect of this cap in future growth will be to continue to allow districts to manage their levies up or down, while gradually lowering the maximum from 3.0 mills over time as valuations increase. This growth cap does not, in any case, require a district to collect less than it does now.
- Imposes an alternative maximum on CO collections, on a per-student basis, at $2800 per student, which is double the approximate state average of $1400 per student. In future years this would inflate at the same rate as the formula – CPI or 3%, whichever is less. This alternative maximum would take effect in FY21, and special provision will be made for districts with capital outlay certificate obligations.
- The new law does not mandate that any current capital outlay funds be shifted to general ed purposes. The capital outlay proposal has no effect on the general ed levies.

Other revenues counted as local effort

Other revenues are funding sources that school districts receive that, in the past, were counted outside of the formula, and therefore not equalized across all districts. The new law will bring equity to other revenues over time by counting these sources as local effort, while giving schools a glide-path to that solution through the phase-in period.

Six sources of other revenue that have the character of a state tax will be counted as local effort. These sources are: gross receipts tax on utilities, local revenue in lieu of taxes, county apportionment of revenue from traffic fines, county revenue in lieu of taxes, wind farm tax, and bank franchise tax.

Initially, each school district will be given a base that will hold its other revenues harmless in the first year, based on the greatest of its collections from FY13, FY14, and FY15. This base will be stepped down over five years, at 20% per year.

Each year, any other revenue collected beyond the “hold harmless base” will be counted as local effort and therefore equalized across districts through the funding formula. At the end of the five-year phase-in, the “hold harmless base” is eliminated and all revenue from these six sources will be counted as local effort and equalized through the funding formula. At that point, these revenue sources will be treated in the same way as local property taxes.

For new wind farm projects, the wind farm taxes will be outside of the formula for five years and then will be phased into local effort over the next five years.

This new money will not offset state or local funding and will not take any funds away from the state’s education system. The Cutler/Gabriel ratio, which determines the share of education expenses paid by the state and by local taxes, will be adjusted so that the state’s dollar amount contribution is not reduced and local property taxes are not impacted.

For districts with very high levels of other revenue, the law also allows an optional alternative to phase into the new formula. School districts that would lose money from this switch have an opportunity to opt out of the new formula, keep their current funding, which will remain frozen at the current amount per student generated through the current funding formula plus revenues from the six other revenues to be equalized. When the inflationary increases to the new formula catch up with that school districts, they can opt into the new formula.

<u>School efficiencies and teacher recruitment and retention</u>
The law provides for the Blue Ribbon Task Force’s recommendations on voluntary shared services, e-learning, and teacher recruitment and retention:

- The e-learning proposal expands the capacity of the NSU e-learning center at an ongoing cost of $1 million, and creates a “classroom innovation grant fund” to incentivize teacher training and classroom access to virtual education and customized learning tools, at an ongoing cost of $1 million. These efforts build upon a recent Bush Foundation $4 million grant received by TIE to develop online learning platforms.
- A mentoring program is created for first and second-year teachers, at a cost of $1 million ongoing.
- The plan reinstates the bonus for achieving National Board Certification, and payment to those teachers who achieved this in the five years since it was suspended, at a one-time cost of $150,000 and estimated ongoing cost of $50,000.
- Expansion of voluntary shared services. The state has already done this successfully in areas such as internet bandwidth and a student information system. The state pays for these services centrally and the school districts receive them for free. The amount that school districts save from not having to procure these services separately exceeds the amount of money the state pays to provide them. The proposal will expand this approach to more areas – such as purchasing, payroll, and software licensing. There will also be incentives for school districts to share staff.

The law appropriates $5 million in ongoing funds be allocated for these proposals. Combined with the new formula need of $64.8 million, this brings the total need to $69.8 million in new funds.

Property tax relief

The legislature allocated 34% of the proceeds of the half-cent sales tax to property tax relief. This will generate approximately $36 million for the first year.

Beginning in 2017, the pension levy is abolished and the average pension levy of 0.233 is added to the general ed levy. In 2016, the current year, the combined general ed and pension levies for each class were as follows:

Agricultural	1.801 dollars per thousand of valuation
Owner occupied	4.308
Other property	8.960 (this includes commercial property and utilities)

For 2017, the pension levy is merged in to the general ed levy. The levies were also adjusted downwards by the Cutler-Gabriel mechanism and further reduced due to $36 million in property tax relief. As a result, 2017 levies are as follows:

Agricultural	1.568
Owner occupied	3.687
Other property	7.630

Had the $36 million in property tax relief not passed, the levies would have been higher:

Agricultural	1.751
Owner occupied	4.107
Other property	8.530

New School Funding Law – Implementation Timeline

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
New formula Target salary $48,500 -Based on student teacher ratio: <200 = 12:1 200-600 = sliding scale of 12-15 >600 – 15:1 *Districts can choose an alternate formula by July 1, 2016.	Target teachers x $48,500 + 29% benefit allowance. Total need increased by 31% for non-instructional costs.	Target teacher salary increases by index factor	Target teacher salary increases by index factor Salaries re-evaluated to determine regional competition	Target teacher salary increases by index factor and any adjustment recommended to stay competitive in the region	Target teacher salary increases by index factor	Target teacher salary increases by index factor Salaries re-evaluated to determine regional competition
Property tax relief	Applied to all classes of property at same ratio as their contribution to local effort after the pension levy change					
Pension levy expenses will be rolled into formula -$19.2 counts against local need	Districts have five years to spend down existing funds so it doesn't count against reserve fund caps				Remaining pension fund balance merged into general fund	
Other revenue Other revenues, except new wind farms, would be counted in the formula as local effort. The statewide total formula need would increase by the amount of other revenues recognized in the formula during the phase in.		Districts held harmless at the base amount and only revenues above that base, excluding any new wind farms, would be equalized - the base would step down by 20% each year -Year 6, FY2023, all of these other revenues would be recognized as local effort	Step down: 80% of the highest amount from the FY2013 through FY2015 compared to FY2017 actual revenues.	Step down: 60% compared to FY2018 actual revenues	Step down: 40% compared to FY2019 actual revenues	Step down: 20% compared to FY2020 actual revenues FY 2023 and future = 0%

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Fund balance caps based on lowest enrollment from the current year or the previous 2 years: < 200 = 40% 200-600 = 30% > 600 = 25%			Calculated by dividing **lowest monthly cash fund balance** of previous 12 months by gen fund expenditures			
Capital outlay -Requires annual requests for capital outlay in the form of a dollar amount instead of a levy	-Cap max amount to 3% or inflation, whichever is less, plus new construction -CO flexibility at 45% may be used on any gen. fund purpose					Maximum on CO collections at $2800 per student -Will inflate at same rate as formula
E-Learning	Opportunities expanded for free courses for difficult to fill positions	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
Mentoring	Statewide mentoring for first and second year teachers Summer academy for new teachers	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
National Board Certification	Funding for teachers obtaining cert. at $1000/five years with match from districts	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
Innovation classroom grants	Funding established to incentivize districts to provide opportunities for teachers and students	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
Voluntary shared services	Schools incentivized for sharing of staff with stipends	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing