



# Investing In Our Future

An Overview of Nebraska's Education Funding System







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## About OpenSky Policy Institute

Our mission is to improve opportunities for every Nebraskan by providing impartial and precise research, analysis, education and leadership.

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# Introduction



Nebraskans are proud of their K-12 education system, and rightly so.

Nebraska students consistently score above the national average on college entrance tests. And the state boasts one of the highest high school graduation rates (86 percent) in the nation, according to the most recent U.S. Department of Education data.

Nebraskans justifiably view spending on public education as a long-term investment in the state’s future.

This primer is meant to promote a vibrant debate on the vital issues surrounding school funding with a clear, precise explanation of how Nebraska has paid for K-12 education in the past and how it does so now.

Chapter 1 of this report goes over the history of school funding in Nebraska. Chapter 2 examines how schools are funded today with local, state, and federal sources. Chapter 3 looks at spending and tax rate lids the Legislature has set for school districts. Chapter 4 evaluates Nebraska’s current school funding system.

It is documented that well-educated workers earn better wages and contribute more to the overall good of the state through taxes they pay on those higher wages. A strong K-12 education system not only expands economic opportunities for all, it helps strengthen the overall economy.

Nebraska’s Constitution says the “Legislature shall provide for the free instruction in the common schools of this state,” but it does not define how it should be done or how to pay for it.

And while the pride and ownership felt by Nebraskans toward public education have been consistent, so has the debate over how to pay for it in an equitable fashion that affords all students equal educational opportunities. As the education funding system has evolved, Nebraska has relied more heavily on local sources of revenue such as property taxes to fund its public schools. In 2011/12, Nebraska K-12 schools relied more on local sources of revenue than those in any other state.

This has created problems in trying to make state funding equitable between districts that have high property values on which to draw for tax purposes and those that don’t.

Today, the dialogue about how the state can best use education funding to adequately provide for the education of all students is shaped by Nebraska's changing demographics – a declining rural population, skyrocketing agricultural land values and increased student needs in many areas.

Meeting the educational needs of everyone in a large, diverse state like Nebraska will always require vigorous debate and periodic reform.

And while the state must remain committed to local solutions to local issues, those debates and reforms will come easier if there is a shared statewide vision for an adequate, equitable education for all Nebraskans.

This primer is meant to be another tool to help legislators, policymakers and citizens better understand the education finance system in Nebraska.

# Chapter 1: History of School Funding



The primary source of funding Nebraska’s schools has always been local property taxes.

And until 1965, the primary means of financing state government came from a general state property tax. That’s when the Legislature created the first state income tax, which triggered an existing constitutional mechanism to automatically eliminate the state property tax – and led to a political battle between the state’s most powerful economic interests.

In 1966, the business community convinced voters to repeal the state income tax. The agricultural community countered with its own ballot measure to eliminate the state property tax, which also passed. That left the state without any real source of revenue.

As a compromise in 1967, the Legislature established a state income tax and a state sales tax as sources of revenue for Nebraska. The Legislature also established the first comprehensive school funding reform measure – known as the School Foundation and Equalization Act.

The three components of the law were:

- **Foundation aid** – Based on the number of students attending a school district.
- **Equalization aid** – A formula meant to equalize the amount of funding between school districts based on property valuation.
- **Incentive aid** – Given to school districts that offered summer school programs, employed teachers with advanced degrees or both.

Lawmakers intended to have the state cover 40 percent of the cost of K-12 education through the School Foundation and Equalization Act. However, the most the state ever covered was 13 percent, despite several legislative efforts to correct the underfunding of the overall state aid formula.<sup>1</sup> So schools continued to rely on local property taxes for the bulk of their funding.

Another concern at the time was that some districts were seen as “tax havens” where property taxes were lower because they included only elementary schools. In other words, a property owner in an elementary-only school district was paying significantly less in property taxes than someone in the adjoining K-12 district.



In one of its most controversial attempts to bring more equity to school funding, the Legislature in 1986 passed a measure (LB662) that would have increased the sales tax rate to generate more state revenue for education. It also would have required more than 1,000 school districts to consolidate to address the tax-haven issue. However, since consolidation was seen by many Nebraskans as a potential loss of local control over their schools, voters rejected the measure in a 1986 referendum, leaving the tax-haven issue unresolved until 1990.

By the 1988/89 school year, there were significant tax and spending disparities between school districts across the state.

School district property tax levies ranged from 75 cents to \$3.25 per \$100 of property valuation – with the highest rates in districts with low property wealth. That meant the owner of property valued at \$100,000 for tax purposes would have been paying anywhere from \$750 to \$3,250 a year in property taxes to the local school district, depending on the location of the property.

Even with the much higher tax levies in low-wealth districts, property tax disparities were so large – and state support did so little to address them – that the districts with the most property wealth had more than five times as much total funding per student as the lowest-wealth district: \$7,120 compared to \$1,313.<sup>2</sup>

The ongoing debate both inside and outside the Legislature over improving school district organization and financing prompted the Legislature to create a 16-member School Finance Review Commission in 1988.

After 18 months of public meetings, public hearings and presentations from staff and outside experts, the commission made five recommendations for a new school finance system:

- Dedicate 20 percent of all state income-tax revenues to public schools.
- Increase the level of state support to 45 percent of schools' operating costs, with the goal of reducing the property taxes used to support schools by 20 percent.
- Implement an equalization-based school aid formula designed to ensure that all school districts have enough money to provide for the needs of their students. The system should measure a school district's wealth by its available state income-tax resources and local property-tax resources.
- Limit how much public school budgets can grow each year.
- Fund school finance on an ongoing and sustainable basis using increases in the state sales tax, income taxes or both.

In its final report, the commission concluded that “the burden on property for school support is excessive by any standard of measurement, resulting in inequities to taxpayers and a narrow and unstable tax base for schools.” It also found that the flawed financing system “does not assure that all students in the state will have equitable access to appropriate and necessary school services.”<sup>3</sup>

Around the time the commission issued its recommendations, a group of landowners in Lancaster County filed a lawsuit in district court (*Gould v. Orr*), arguing that the school finance system deprived some students of equal and adequate educational opportunities and failed to provide a uniform, proportionate tax system to help fund schools.

Meanwhile, a group of anti-tax activists launched a ballot initiative to limit increases in overall state and local government spending to 2 percent a year – which would have kept school spending below what lawmakers had determined was necessary.

The specter of the Gould lawsuit and the spending cap initiative prompted the Legislature in 1990 to pass a comprehensive education and revenue reform measure (LB1059), known as the Tax Equity and Educational Opportunities Support Act, or TEEOSA for short. The measure increased state support for school districts by attempting to shift a significant portion of K-12 funding from property taxes to state income and sales taxes. It also limited annual growth in school district spending to a range of 4 percent to 6.5 percent. It should be noted that the Legislature can – and has – adjusted that figure periodically.

Also in 1990, the Legislature took a less controversial approach to mandatory school consolidation, requiring each elementary-only district to affiliate with a K-12 district for tax purposes – without forcing them to physically consolidate. It required the tax levies in both districts to be identical. Students in elementary-only districts would remain in their local elementary school and then go to high school in the affiliated district.

In 1993, the Nebraska Supreme Court upheld a lower court’s dismissal of the Gould case, ruling that the state Constitution does not guarantee equal funding of schools. It also ruled that the plaintiffs failed to prove that unequal funding of schools affected the quality of the education students were receiving. But a dissenting opinion, some felt, left open the possibility for another lawsuit based on a claim challenging the “adequacy” of education.<sup>4</sup>

Two subsequent events left the issue of educational adequacy to the discretion of the Legislature: the voters’ rejection in 1996 of Initiative 411, which would have made a “quality education” a constitutional right, and a 1997 Nebraska Supreme Court ruling that claims regarding “adequate” and “quality” education were political

questions that could not be decided by a court of law. <sup>5</sup>

### **The Cornerstone of Nebraska’s Education Funding System: LB1059**

LB1059 set the basis for the present state aid formula and replaced the School Foundation and Equalization Act that had been in place since 1967.

While the overall goals of LB1059 mirrored the goals and recommendations of the School Finance Review Commission, its overriding focus was on lowering property taxes.

A member of the commission testified at a legislative hearing that more than 70 percent of the aggregate cost of running public schools in Nebraska came from local support – such as property taxes – compared to a national average of less than 45 percent: “While state governments across the United States have assumed a greater responsibility for public education, Nebraska in recent years has gone the other direction ... ”.<sup>6</sup>

LB1059 raised state sales and income tax rates to broaden the available financial support for public schools, attempting to lessen the reliance on local property taxes, and created the basic concept for the present state aid formula.

That concept (**Needs minus Resources = Equalization Aid**) is meant to provide enough state aid to a school district to help make up some of the difference between its needs and the local resources it can tap, such as taxable property. This difference is called “equalization aid.”

- **Needs** are what it costs the school district to educate its students.
- **Resources** are the revenue sources – such as taxable property – a school district may access to generate money for educating its students.
- **Equalization Aid** is distributed by the state to help make up the difference between the needs of a school district and its resources.

Following passage of LB1059, Nebraska’s business community made an attempt to repeal the legislation by ballot measure in the 1990 general election. Also on the ballot was the attempt to limit overall government spending.

Some 56 percent of the voters supported retaining LB1059, while about 70 percent rejected the spending cap.

While the basic concept of LB1059 has not changed since 1990, the statutes governing state aid have been tweaked several times. Many of those changes were made to try to direct equalization aid to districts with needs such as high transportation costs, high demand for special education or a large number of students living in poverty.

In addition, the formula used to determine equalization aid has been regularly changed during legislative negotiations to balance the state budget, which often results in less state aid to schools. For example, LB235 (2011) made multiple changes to the formula that reduced state funding an estimated \$189 million in 2011/12 and \$222 million in 2012/13 as part of efforts to reduce the state budget in the wake of the Great Recession.<sup>7</sup> Overall, state aid has declined 14 percent since 1992/93 as a share of the economy.<sup>8</sup>

One of the more significant changes since the enactment of LB1059 was the formation of a “Learning Community” in the Omaha area in 2006. It is a group of school districts that has a common property tax levy and is governed by a coordinating council. The Learning Community shares the common property tax revenue and state aid based on the needs of each member school district.

The purpose of the Learning Community was not only to share resources and equalize resources, but also to address the challenges of urban education on a broader basis than just one district. It allows school districts to create specialty programs to attract students from across the Learning Community so that each district does not have to offer such programs to a limited student population.

The Learning Community of Douglas and Sarpy Counties consists of 11 school districts (Omaha, Elkhorn, Douglas County West, Millard, Ralston, Bennington, Westside, Bellevue, Papillion, Gretna, and South Sarpy).

#### Footnotes

- 1 Michael S. Dulaney, *The History of the Nebraska Tax Equity and Educational Opportunities Support Act* (Dissertation Presented to University of Nebraska: March 2007), p. 34.
- 2 *Gould v. Orr*, 244 Neb 163, 506 N.W.2d 349 (1993).
- 3 Nebraska School Financing Review Commission, “Funding Nebraska’s Schools: Toward a More Rational and Equitable School Finance System for the 1990s,” 1990.
- 4 “School Funding Cases in Nebraska,” National Education Access Network, May 2012.
- 5 *Nebraska Coalition for Educational Equity and Adequacy Coalition v. Heineman*, 273 Neb. 531, 731 N.W.2d 164 (2007)
- 6 *Hearing transcripts, LB 1059 (1990)* 23 January 1990, p. 22, <http://schoolfinance.ncsa.org/teeosa#anchor49>
- 7 LB 235 Fiscal Note, Legislative Fiscal Office, April 13, 2011.
- 8 Nebraska Department of Education *Annual Financial Reports* and US Bureau of Economic Analysis Personal Income data.

# Chapter 2: A Closer Look at the Components of School Funding

School districts in Nebraska get revenue from local, state, and federal sources.

From all revenue sources combined, Nebraska school districts received \$3.23 billion for public education in 2012/13.<sup>9</sup>

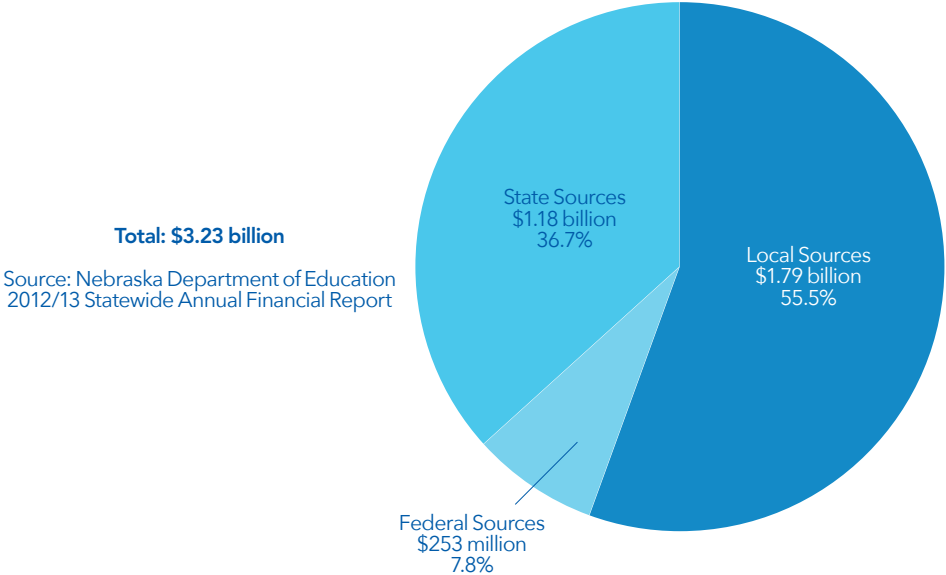
Despite ongoing efforts to increase state support for education and reduce the reliance on local property taxes, Nebraska continues to rely heavily on property taxes and other local sources to fund K-12 education. More than 55 percent of total school funding comes from local sources (see Figure 1). Of that total, 90 percent comes from property taxes collected by school districts – some \$1.6 billion in 2012/13.

### Local Sources

Local property taxes are generated from a school district’s tax levy and the amount of value placed upon homes, businesses and agricultural property for tax purposes in its jurisdiction.

School districts are among the 31 types of political subdivisions that rely on property tax dollars in Nebraska.<sup>10</sup> Among these are cities, counties, community colleges, natural resource districts, and sanitary improvement districts.

**Figure 1: How Nebraska Schools Are Funded**



But school districts use 60 percent of all property taxes collected in the state, according to the Nebraska Department of Revenue's Property Assessment Division.

Other local sources of school revenue include public power district sales taxes, motor vehicle taxes, tuition/fees and transportation.

### **State Sources**

There are several state sources of revenue for Nebraska school districts. They accounted for \$1.18 billion in 2012/13 – or about 37 percent of total revenue.

And while all Nebraska school districts receive state funding, it is important to note that not every school district receives funding from every state source.

Key definitions used in Nebraska's school finance system:

- **State Support** – All funds provided to districts by the state for the general support of elementary and secondary education.
- **State Aid (also called TEEOSA Aid)** – A component of state support paid to a district under the state aid formula.
- **Equalization Aid** – A component of state aid, which is meant to help schools make up the difference between the money they can raise through local sources, such as taxable property value, and what they need to educate their students.

### **State Aid**

This is the largest source of state funding for schools, accounting for \$852 million – or 26 percent – of the total revenue for school districts in 2012/13.

All school districts receive state aid; however, not all school districts receive equalization aid. As noted above, equalization aid is a component of state aid. A school district may be equalized<sup>11</sup> or non-equalized<sup>12</sup> within the state aid formula.

In the 2012/13 school year, 102 of the state's 249 school districts were non-equalized – meaning they did not receive equalization aid. In 1990/91, 20 of the state's 278 K-12 school districts were non-equalized. Equalization aid was \$756 million – 89 percent — of the total amount of state aid.

*Every school district receives state aid. Not every school district receives equalization aid.*

## The State Aid Formula

The intent of LB1059 was to reduce school districts' heavy reliance on local property taxes and create a more equitable tax load among taxpayers in school districts of similar size with significant disparities in property wealth.

The formula is complex because it must account for the unique needs and differences of Nebraska's 249 school districts – schools large and small, urban and rural, and those with high property wealth and low property wealth. The state aid formula establishes the components of need and the components of resources for the calculation of state aid.

The aid calculation requires several steps (depicted in Figure 2 on page 14):

### **Step 1 – Determining Needs**

These are the costs a school district incurs to educate its students. The needs calculation includes components (23 in 2012/13) that take account of things such as the number of students in poverty and transportation costs.

**Basic Funding** is the largest component (85 percent) of the needs calculation and is used to determine how much a district should theoretically spend compared to school districts with similar numbers of students. This helps smooth out spending between districts to make sure that all students have educational opportunities that are as equal as possible. (All of the components are listed in Appendix A.)

### **Step 2 – Calculating Resources**

The formula uses another set of components to determine how much revenue a school district has to fund its needs.

The largest component is called the **Yield from Local Effort Rate**. The yield is based on a "local effort rate"<sup>13</sup> – a theoretical tax rate set by statute to determine how much a school district could potentially collect at the local level. The local effort rate does not determine the actual local property tax dollars a school district will receive.

Other components of the resource calculation include:

- A portion of state income taxes paid by taxpayers in the school district (known as the **Allocated Income Tax**).
- Specific local and state sources of revenue set in statute, such as interest earned on investments and tuition received from other districts.
- State funding for educating students who exercise the option to attend a school outside their home district (known as **Net Option Funding**).
- A reduction in state aid for school districts with tax levies below 95 cents (known

as the **Minimum Levy Adjustment**). This is meant to ensure school districts put forth a minimum amount of effort to tax. In the 2012/13 school year, 60 of Nebraska's 249 districts had levies below 95 cents.

(A detailed explanation of the components of the resource calculation is in Appendix B.)

### **Step 3 – Setting Equalization Aid**

This is meant to bridge the difference between what a district needs to educate its students and its available resources.

A school district receives equalization aid only if its needs exceed its resources. In 1990/91, just 7 percent of the state's K-12 schools (20 of 278) received no equalization aid. Nearly 41 percent of the state's school districts (102 of 249) received no equalization aid in 2012/13.

### **Step 4 – Adding Additional Items**

The amount of state aid that is calculated for a school district is the sum of:

- **Equalization Aid**
- **Net Option Funding**
- **Allocated Income Tax**
- Any under-payment or over-payment of state aid from the prior year (known as the **Prior Year Correction**), after data estimates are reconciled with actual data.

In 2012/13, total state aid included **Retirement Aid**, which helps pay for employee retirement costs.

Figure 2 shows the basic concept of state aid (Needs minus Resources = Equalization Aid) and the additional items that are added to equalization aid to arrive at the total state aid for a school district. Net option funding, allocated income tax and retirement aid are components of available resources and are added back to equalization aid to determine the total state aid amount. The prior year correction is not part of the resources calculation; it is only added to equalization aid to determine total state aid.

For the school districts in the Learning Community of Douglas and Sarpy Counties, needs and resources are calculated separately and then summed to determine equalization aid for the Learning Community. Equalization aid, allocated income taxes and the common property tax revenue are distributed based on each member district's needs relative to the overall needs of the Learning Community. Net option funding and retirement aid – specific to each member school – are added to equalization aid to determine total state aid for these school districts.



**Figure 2: How 2012/13 Total State Aid was Calculated**

STEP 1	STEP 2	STEP 3	STEP 4	
<b>Needs</b>	<b>- Resources</b>	<b>= Equalization Aid</b>	<b>+ Additional Items</b>	<b>= Total State Aid</b>
<b>The sum of:</b> Basic Funding Poverty Allowance Limited English Proficiency (LEP) Allowance Elementary Class Size Allowance Focus School & Program Allowance Summer School Allowance Special Receipts Allowance Averaging Adjustment Teacher Education Adjustment New School Adjustment Student Growth Adjustment Learning Community Transportation Adjustment Poverty Allowance Correction LEP Allowance Correction Non-Qualified Poverty Adjustment Non-Qualified LEP Adjustment Local Choice Adjustment Student Growth Adjustment Correction	<b>The sum of:</b> Yield from Local Effort Rate Net Option Funding Allocated Income Tax Minimum Levy Adjustment Retirement Aid Other Receipts Actually Received by the District		<b>The sum of:</b> Net Option Funding Allocated Income Tax Retirement Aid Prior Year State Aid Correction	

The **Cost Growth Factor**<sup>14</sup> – which adjusts two-year-old expenditure data to help set the basic funding level for school districts for the current year – and the **Local Effort Rate** – a theoretical tax rate used in the calculation of resources – are the main pieces of the state aid formula that affect the total dollar amount of state aid. When the Legislature determines that the total amount of state aid to be distributed should be adjusted because of overall state revenue shortfalls, it will typically revise the cost growth factor and/or the local effort rate.

- Increasing the local effort rate and/or decreasing the cost growth factor reduces the amount of state funding required by state aid. This increases pressure on local property taxes.
- Decreasing the local effort rate and/or increasing the cost growth factor increases the amount of state money required by state aid. This reduces pressure on local property taxes.

## Other Sources of State Revenue

The state also provides funding to schools – that is not part of state aid – for other expenses, such as special education costs. This funding accounted for \$332 million – or about 10 percent – of the \$3.2 billion of 2012/13 total revenue for school districts. (See Table 1.)

**Table 1: Other State Revenue**

Source of State Revenue	Amount	Share of Total School District Revenue
Special Education	\$187 Million	5.8%
Property Tax Credit	\$47 Million	1.5%
State Apportionment	\$46 Million	1.4%
Homestead Exemption	\$33 Million	1.0%
State Categorical Programs	\$8 Million	0.2%
Early Childhood Grants	\$4 Million	0.1%
Other State Receipts	\$7 Million	0.2%

Source: 2012/13 Statewide Annual Financial Report, Nebraska Department of Education, <http://www.education.ne.gov/FOS/ASPX/Search.aspx?id=2>

## Federal Sources

School districts receive funds from a number of federal programs. One of them is the 2001 No Child Left Behind Act (NCLB), which is the federal government’s main program for helping disadvantaged students. Another is the Individuals with Disabilities Education Act (IDEA), which governs how states provide services and education to children with disabilities.

In 2012/13, federal dollars provided 8 percent of total funding for Nebraska school districts – \$95 million from NCLB<sup>15</sup> and \$76 million from IDEA.<sup>16</sup> Other available federal sources of revenue are found in Table 2.

**Table 2: Other Federal Revenue**

Source of Federal Revenue	Amount	Share of Total School District Revenue
Title 8 (Impact Aid)	\$21 Million	0.7%
Categorical Grants from Corporations & Other Private Interests	\$14 Million	0.4%
Medicaid Administrative Activities (MAAPS)	\$12 Million	0.4%
Head Start	\$10 Million	0.3%
REAP (Small Rural School Achievement Grants from U.S. Dept. of Ed)	\$4 Million	0.1%
MEDICAID in Public Schools	\$3 Million	0.1%
Universal Service Fund (E-Rate)	\$3 Million	0.1%
Federal Vocational & Applied Technology Education (Carl Perkins)	\$2 Million	0.1%
Other Federal Receipts	\$7 Million	0.2%

Source: 2012/13 Statewide Annual Financial Report, Nebraska Department of Education, <http://www.education.ne.gov/FOS/ASPX/Search.aspx?id=2>

Footnotes

- 9 Nebraska Department of Education, 2012/13 Statewide Annual Financial Report, <http://www.education.ne.gov/FOS/ASPX/Search.aspx?id=2>.
- 10 A complete list of the 31 types of political subdivisions may be found in Nebraska Statute §13-503(1).
- 11 A school district is equalized when its Needs exceed its Resources. This means the school district receives equalization aid.
- 12 A school district is non-equalized when its Needs are less than its Resources. This means the school district receives no equalization aid.
- 13 The local effort rate (LER) is set by Nebraska Statute §79-1015.01(3). For 2013/14 the LER was 1.0395.
- 14 For 2012/13, the cost growth factor was 1.005. It is used to increase the actual expenditures used to calculate basic funding. The cost growth factor is 1 + the basic allowable growth rate for the year in which aid is to be distributed (.005) + the basic allowable growth rate for the immediately preceding school fiscal year (.00).
- 15 Examples of NCLB programs are: Title I NCLB Improving the Academic Achievement of Disadvantaged, Title II NCLB Teacher Quality Grants, Title IV NCLB 21st Century Community Learning Centers.
- 16 Examples of IDEA programs are: IDEA Part B Base Allocation, IDEA Enrollment/Poverty, IDEA Part C, and IDEA Special Projects.

## Chapter 3: Spending and Tax Restrictions



The School Finance Review Commission concluded that some limits on school district budget growth should be a necessary part of the school funding system to ensure that a portion of the new state money sent to school districts would be used to keep local property taxes down, rather than just be added to existing budgets. So lawmakers set limits in LB1059 on the growth of local school spending.

In 1996, the Legislature added a property tax levy limit – now at \$1.05 for each \$100 of a property’s taxable value – to the restrictions on school district budgeting. The levy limit is discussed further on page 18.

School districts are the only Nebraska political subdivisions with both a spending limit and a property tax levy limit. A school district must consider multiple factors when balancing its budget – trying to provide the best education for its students while staying within the spending limit and the property tax limit.

### Spending Limit

The spending limit works by applying a rate of growth (**Basic Allowable Growth Rate**) to the main portion of each district’s budget, based on the prior year’s budget.

The amount a school’s budget can grow from year to year is currently limited to 2.5 percent, although the Legislature is allowed to annually change the growth rate. For instance, lawmakers dropped the growth rate for 2012/13 to 0.5 percent.<sup>17</sup>

### Expenditure Exclusions & Overrides

Expenditure exclusions are items that are not subject to the spending limit. The two largest are special education expenditures and special grant funds – such as money given to a school district that must be used for a specific purpose like purchasing distance learning equipment. (A list of the remaining expenditure exclusions is in Appendix C.)

A school district that cannot meet its needs without exceeding the spending limit can hold a special election to ask voters to approve an override to spend more money. If the voters approve the additional spending, it is only in effect for one year. But such elections are rare.

### Limitation on Cash Reserves

The amount of money that school districts can hold in reserve from year to year is also limited. That is to ensure that additional state dollars sent to a district are used for local property tax reduction.

## **Property Tax Limit**

Since the passage of LB1059, the Legislature has tried other ways to curb schools' reliance on local property taxes, including the property tax limit passed in 1996.

By law, the maximum property tax levy for school districts is \$1.05 per \$100 of property value. There are exceptions to this limit, which are discussed below.

## **Levy Exclusions & Overrides**

There are levy exclusions that allow a school district to exceed the \$1.05 maximum levy without voter approval. The most common exclusion is for early retirement or other employee buy-out arrangements.

About 10 percent of the 249 school districts used levy exclusions to tax above the \$1.05 maximum in 2012/13. (A list of the levy exclusions is in Appendix D.)

A school district that cannot generate the property tax dollars it needs – even after using all available levy exclusions – may ask the district's taxpayers to approve a higher levy through a levy override.

A levy override is only good for a maximum of five consecutive years. In 2012/13, levy overrides were in effect in 19 school districts, though only seven of these were actually taking advantage of the override that particular year.

A vote to override the levy is different than a vote to issue bonds. A vote to issue bonds gives the school district the money to build new facilities or renovate current facilities. This vote does not provide additional money for the general operation and maintenance of a school district. However, a taxpayer may see their total taxes increase if the vote to issue bonds is successful.

## **The Combined Impact of Spending and Property Tax Limits**

The combination of these limits can constrain a school district's budget flexibility.

For example, a school district with an 85 cent levy would have room to increase its levy to \$1.05 without voter approval. But the spending limit might prevent the district from doing so because it would, in theory, raise more money than it would be allowed to spend.

By contrast, a school district at \$1.05 may still be able to spend more money under the spending limit, but could not bring in more money to do so through increased property taxes because it is at the levy limit.

Furthermore, a school district that does not have a property tax levy of at least 95 cents will see a reduction in the amount of its state aid through the minimum levy adjustment. However, as mentioned above, some school districts effectively cannot raise their property tax levy to 95 cents because of the spending limit. Those districts see their aid reduced for something beyond their control.

All of this fuels the debate over local control of schools and the state's effort to control local property taxes and spending, while at the same time trying to provide adequate amounts of state support.

### Footnotes

17 The basic allowable growth rate for 2013/14 was 1.5% and 2.5% for 2014/15.

# Chapter 4: Evaluating the Nebraska Education Funding System

## K-12 Funding Heavily Reliant on Property Taxes

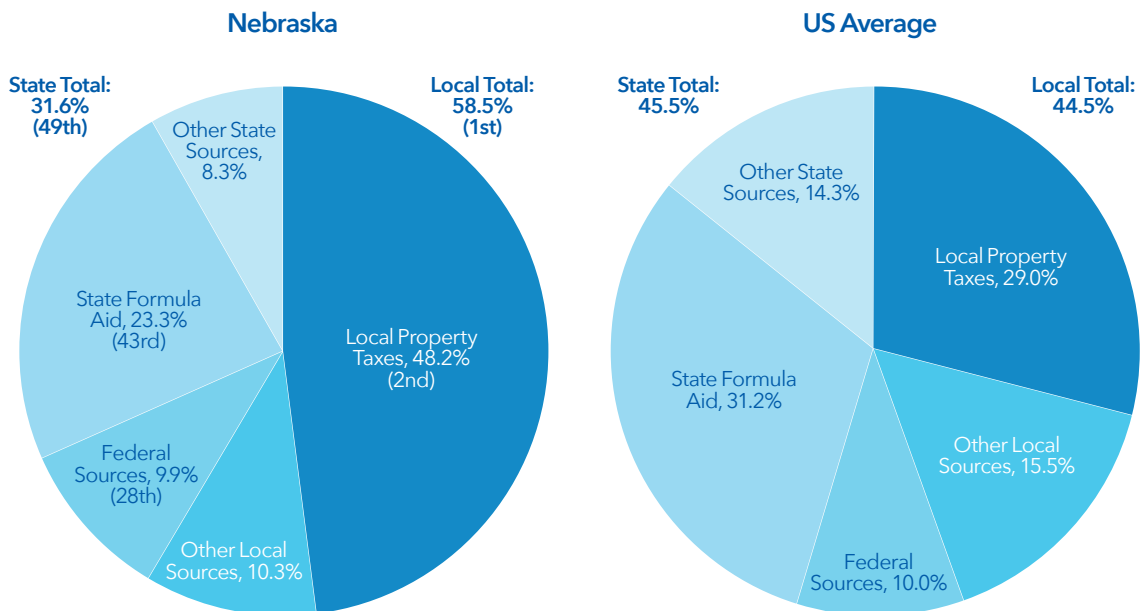
A regular complaint among Nebraska property owners is they pay too much in property taxes, and the push to reduce property taxes has been a recurrent theme in the debate over how schools are funded. That point was consistently raised during the debate of LB1059 and again took center stage during the Tax Modernization Committee and Education Committee hearings in 2013.

LB1059 tried to address these concerns by increasing sales and income taxes to take some of the pressure off property taxes as a school funding source. LB1114 (1996) established the property tax levy limit.

These efforts were able to reduce the highest tax levy from \$3.25 per \$100 of property tax valuation in 1989/90 to \$1.20 by 2012/13.

Nonetheless, Nebraska today relies more on local property taxes to fund public schools than 48 other states. About 58 percent of education funding in Nebraska comes from

**Figure 3: How Nebraska Compares to the National Average**  
Public school funding by source, 2011/12



Source: US Census Bureau, 2012 Annual Survey of School System Finance

property taxes and other local resources, compared to the U.S. average of about 45 percent, according to the most recent data (2011/12) from the U.S. Census Bureau.

As Figure 3 shows, Nebraska relies more on local revenue sources such as property taxes as a share of K-12 funding than the national average. Likewise, Nebraska ranks 49th in state funding as a share of K-12 funding.

The heavy reliance on local property taxes and low level of state support in Nebraska have been noted in four major tax studies in the state's history:

- A 1962 study (McClelland) found that "in comparison with surrounding states, Nebraska provides a minimum of financial assistance to local governments, particularly in the field of education."<sup>18</sup>
- The 1988 "Syracuse Study" found that "Nebraska's assistance to its local governments is farther out of line with practice in the rest of the country and from accepted principles of public policy than any other aspect of public finance in the state."<sup>19</sup>
- The 2007 Burling Commission found that "Nebraska's property taxes are high by every measure looked at... [and] Nebraska's state aid to local government ranks among the very lowest of all states." It also noted urban-rural tensions over school funding and concluded that "the relative lack of state funding for education compared to other states magnifies this problem."<sup>20</sup>
- Finally, the Tax Modernization Committee of 2013 found that "Nebraska makes greater use of the property tax to fund public services than other states in the nation or region. Achieving the same average balance of sources in the region or nation would require a \$200 million to \$300 million shift and reduction in use of property tax."<sup>21</sup>

### **State Support for Nebraska Schools**

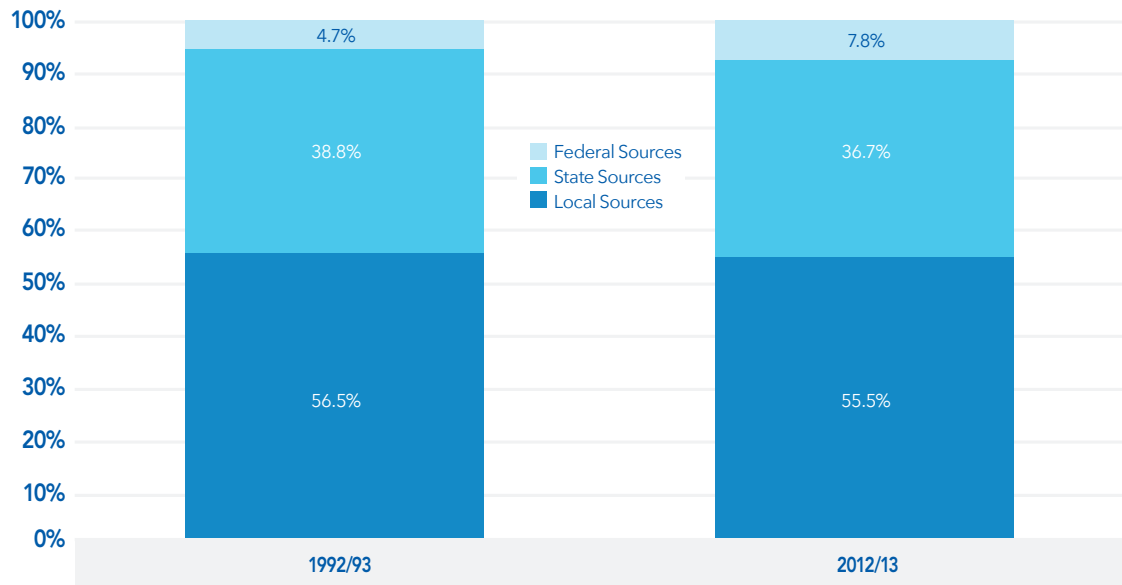
Historically, state support for Nebraska schools has fallen short of targets set by lawmakers.

For example, LB1059 set a goal for the state to provide at least 45 percent of the operating costs for public school districts. The state has yet to meet this goal – for the most recent year, state sources are funding 41 percent of operating costs, \$115 million below the goal.

When LB1059 passed in 1990, Nebraska ranked 49th nationally for the percentage of K-12 funding provided by the state. Despite the law and other attempts to significantly increase state support, in 2011/12 Nebraska still ranked 49th nationally in the percentage of state support for schools.<sup>22</sup>



**Figure 4: School Funding Mix Has Changed Little**  
 Share of total school revenues by source, 1992/93 and 2012/13



Sources: Nebraska Department of Education Statewide Annual Financial Reports

Figure 4 shows how little the mix of state, local, and federal revenue sources has changed since 1992/93, according to Nebraska Department of Education Annual Financial Reports.<sup>23</sup>

In 1996, lawmakers changed the state aid law to allow the school funding formula to determine how much to spend on education. However, the amount of state aid to be distributed has instead been determined by the Legislature, often to help balance the state budget. The statutes are amended so the formula will calculate the amount determined by lawmakers.

Since LB1059 was passed, the state aid formula has been changed 16 times to varying degrees – often to accommodate the money available in the state budget.

### **Equity Issues in Nebraska’s Education Finance System**

Heavy reliance on property taxes combined with relatively low state support and spending/levy limits creates inequities. That’s because funding is generally driven by the property valuation in a district – something over which students, their families and schools have no control.

Inequities can occur between tax rates and per-pupil funding among districts – and raise questions about unequal educational opportunity across the state.

## Tax Rate Inequities

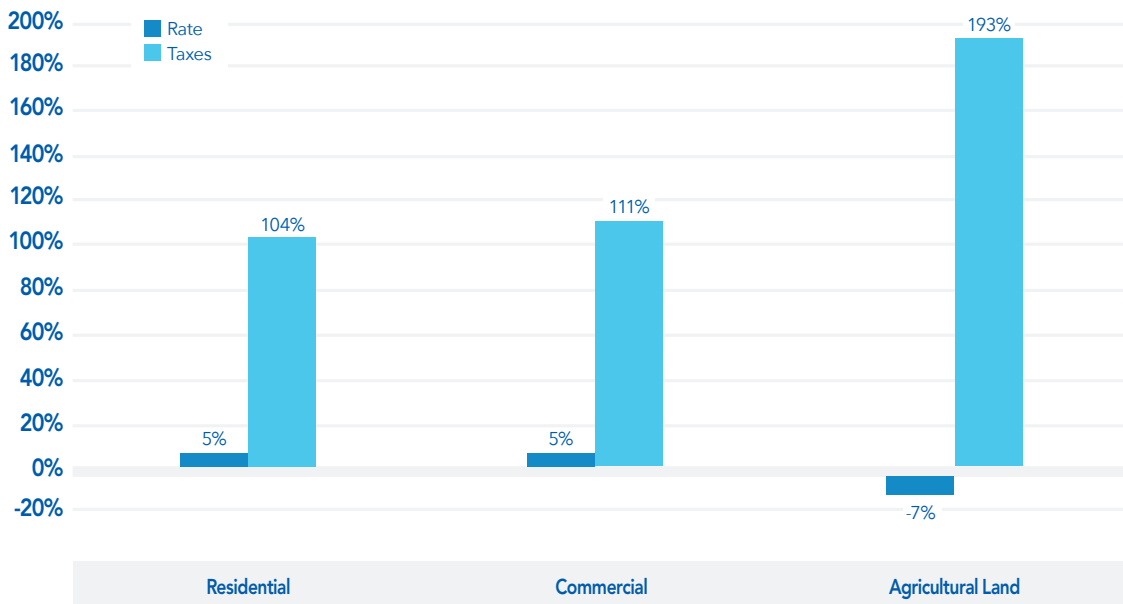
Disparities in tax rates have driven much debate over education finance and reform efforts.

- In 1989/90, the highest school district general fund property tax levy in Nebraska was more than four times greater than the lowest. Levies ranged from 75 cents per \$100 of property tax valuation to \$3.25.
- In 2012/13, the highest school district general fund property tax levy in Nebraska was 2.8 times greater than the lowest. Levies ranged from 43 cents per \$100 of property tax valuation to \$1.20.

While rural tax levies tend to be lower than urban levies, rural schools usually have significantly more property value per student. And since 1999, agricultural land values have skyrocketed, giving rural schools even more resources under the state aid formula. (See Figure 5.)

Meanwhile, the needs of urban schools under the formula have increased due to such factors as student population growth at a time when student poverty rates have increased statewide.

**Figure 5: Property Tax Growth for Agricultural Land Has Far Outpaced Other Property Types**  
Percent change in rate and total taxes, 1999 to 2013



Sources: Nebraska Department of Revenue Property Assessment Division

So while rural communities aren't necessarily wealthier (higher land values may not translate into higher farm income), the state aid formula recognizes increasing property valuation as an increase in available resources. That means that a district with a low property tax levy but increased property valuations will get less state aid.

### Per-Pupil Funding Inequities

States that rely heavily on property taxes to fund schools tend to have large gaps across districts in the amount of money that is spent per pupil to educate children.<sup>24</sup> Schools in areas with shopping malls, expensive homes and other property wealth are able to spend much more than schools in areas with little property wealth. How much state support should be going to schools is a constant source of debate in these states.

In Nebraska, the K-12 funding formula attempts to equalize resources and thus eliminate funding inequities among school districts by sending more state money to those school districts with less property value. In other words, schools with high property values are expected to raise more money through local resources, and those with less property value receive a higher proportion of state dollars.

However, as Table 3 shows, even after state support is included, school districts with high property values are able to spend nearly twice as much per pupil as those with low property values.

Districts with high property values are able to raise more from local property taxes per

**Table 3: High-Low Property Districts**

	Top 20% High Property Value Districts	Bottom 20% Low Property Value Districts
Average Assessed Value Per Pupil	\$1,908,157	\$420,304
Average General Fund Tax Levy	\$0.7620	\$1.0567
Average General Fund Property Taxes Levied Per Pupil	\$14,539	\$4,441
Average Equalization Aid Per Pupil	\$47	\$3,191
Average Total State Aid Per Pupil	\$423	\$3,480
Average Total State Sources Per Pupil (excluding state aid)	\$1,005	\$378
Total General Fund Expenditures Per Pupil	\$17,029	\$9,654

Source: 2012/13 Statewide Annual Financial Report and 2012/13 State Aid Certification, Nebraska Department of Education; 2012 Certificate of Taxes Levied, Nebraska Department of Revenue

pupil and still have a lower property tax levy (an average of 76 cents) than those with low property values, who tend to have a higher property tax levy (an average of \$1.06). Table 3 shows that high property value districts have more than three times as much property tax revenue per pupil than those with low property values.

And state support does not completely mitigate these disparities. State aid delivered through the formula allocates more state money to low property value schools. But other state sources – outside of the formula – send more money to the wealthier districts.

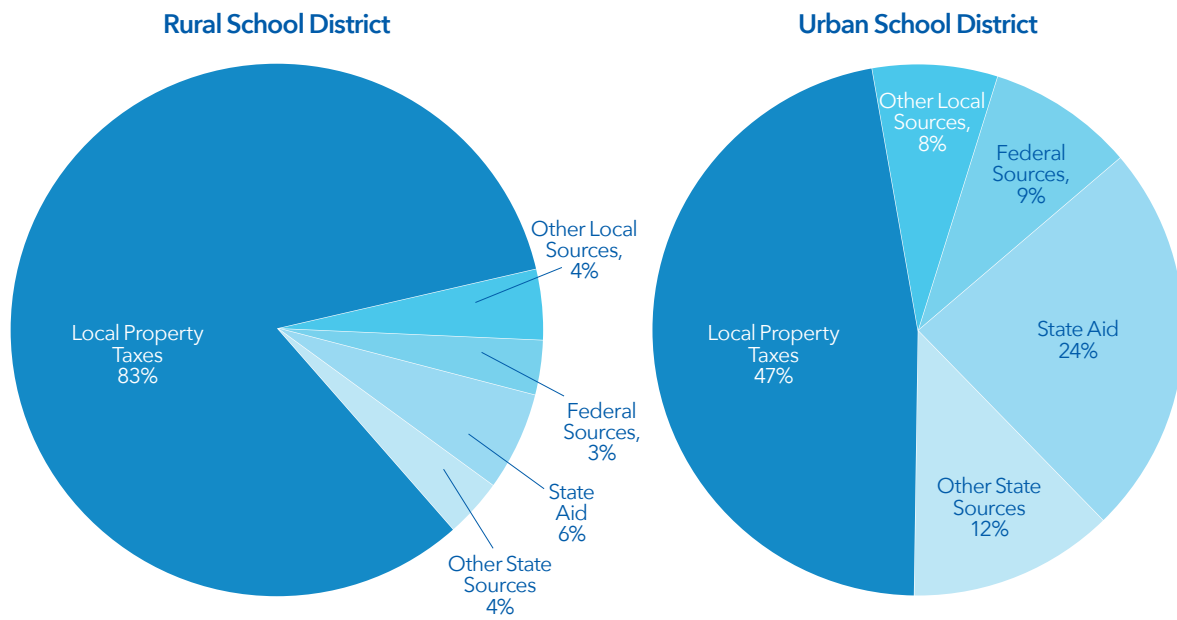
While there are other factors that contribute to per-pupil funding inequities – such as the economies of scale that are found in schools with a large number of students – the fact that those districts with the lowest spending tend to have the highest tax levies warrants further discussion.

### How These Inequities Play Out: Rural Schools More Reliant on Property Tax Revenue while Urban Schools Have Higher Tax Rates

It can be helpful to look at a specific example contrasting a rural and an urban school district.

The 2012/13 actual revenues generated by the school funding system for a rural school district and an urban school district are shown below in Figure 6. Each school district relies heavily on local property taxes to fund its education programs: they represent 83

**Figure 6: Funding Mix in a Rural and an Urban School District**



Source: Nebraska Department of Education 2012/13 Annual Financial Reports

percent of the total revenue for the rural school district and 47 percent for the urban school district.

State aid provides 6 percent of the total revenue for the rural school district and 24 percent of the total revenue for the urban school district.

- The rural district has a general fund levy of 96 cents. The urban school district has a general fund levy of \$1.05.
- The property tax valuation per student for the rural school district is \$1.96 million. The property tax valuation per student in the urban district is \$482,000.
- The rural school district spends \$24,667 to educate each student, which is \$13,629 more than the statewide average of \$11,038.
- The urban school district spends \$10,046 to educate a student, which is \$992 lower than the statewide average.

The notable difference in the school funding system for these two schools is the property tax valuation behind each student. The rural school district has more than four times as much property tax valuation behind each student as the urban school district. The difference in the amount of local and state sources of revenue is directly related to this difference.

Because the state aid formula relies so heavily on local property values to calculate the resources of schools, the result is that urban school districts need more state aid even though they tend to have higher property tax levies.

But at the same time, the rural districts are seeing a loss of state aid due to increasing agricultural land valuations. Meanwhile, agricultural landowners are not seeing incomes rise as fast as land values, so more of their income is being taken up by increased property taxes.

These dynamics have fueled the ongoing rift in the Legislature and pitted urban and rural school districts against each other in the fight for state funding.

### **Inequities in Educational Opportunities**

The courts have clearly left it up to the Legislature to determine how to fund K-12 education, and unlike many other states, Nebraska's Constitution does not require an adequate or quality education.

Yet the potential for inequities in educational opportunities manifests itself in different ways. Can a district with low per-pupil spending provide the same quality as a district spending twice as much? On the other hand, large districts are able to offer a greater

variety of courses, such as foreign languages, than many small districts. Does this create disparities in educational opportunities?

Until recently there has been little evidence that increased funding necessarily improves educational outcomes. However, increases in school spending were found to lead to substantial improvements in graduation rates and other achievements for children from poor families in a 2014 study by the National Bureau of Economic Research.<sup>25</sup> With 44 percent of Nebraska's students living in poverty in 2012/13 compared to 32 percent in 2002/03, Nebraskans would do well to take heed of this research.<sup>26</sup>

"... increasing per-pupil spending by 20 percent for a child's entire K-12 schooling career increases high school completion by 22.9 percentage points, increases the overall number of years of education by 0.928, increases adult earnings by about 24.6 percent, increases annual family income by 52.2 percent, and reduces the incidence of adult poverty by 19.7 percentage points."<sup>27</sup>

However, similar increases in per-pupil spending for non-poor children were not found to have the same impact. So how can we utilize the school funding system to provide an adequate education and at the same time ensure we are getting resources to where they are most needed and have the greatest impact?

While Nebraska's Constitution doesn't require the state to provide for an adequate, quality education, there are many reasons to consider this question as we evaluate Nebraska's K-12 funding system.

#### Footnotes

18 Harold F. McClelland, for Nebraska Legislative Council Committee on Taxation, 1962.

19 Maxwell School of Syracuse University, *Nebraska Comprehensive Study Final Report*, July 1988, p. 28, [http://nebraskalegislature.gov/pdf/reports/committee/select\\_special/lr155\\_syracuse.pdf](http://nebraskalegislature.gov/pdf/reports/committee/select_special/lr155_syracuse.pdf).

20 Nebraska Tax Policy Commission (known as the Burling Commission), *Final Report*, November 2007, pp. 4-16 and 4-17, <http://nlc1.nlc.state.ne.us/epubs/L3790/B068-2007.pdf>.

21 Nebraska's Tax Modernization Committee, *Balancing the Scales: A Comprehensive Review of Nebraska's State-Local Revenue System*, 2013, p. 33, [http://www.nebraskalegislature.gov/pdf/reports/committee/select\\_special/lr155\\_taxmod2013.pdf](http://www.nebraskalegislature.gov/pdf/reports/committee/select_special/lr155_taxmod2013.pdf).

22 2012 Public Elementary-Secondary Education Finance Data, U.S. Census Bureau.

23 Note that percentages in Figure 4 differ from those in Figure 3. Figure 3 uses Census data from 2011/12 in order to make a comparison to other states, whereas Figure 4 uses Nebraska Department of Education data that is slightly different and more recent. Secondly, the 37 to 39 percent shown for state sources in Figure 4 is someone different from the 41 percent mentioned in the text above, because this figure reflects each source's share of total revenues, not the share of operating costs.

24 *The Stealth Inequities of School Funding*, Baker & Corcoran, September 2012.

25 Jackson et al, *The Effect of School Finance Reforms on the Distribution of Spending, Academic Achievement, and Adult Outcomes (May 2014)*, Jackson\_Johnson\_Persico\_SFR\_LRImpacts.pdf.

26 Nebraska Department of Education, *State of the Schools Report Cards*, <http://www.education.ne.gov/documents/SOSR.html>, retrieved July 21, 2014.

27 Jackson et al, p. 44. .

# Conclusion



Nebraskans' passion for strong K-12 education is evident by the ongoing dialogue about how best to develop a fair and equitable funding system.

Fueling that conversation are the unique situations facing urban and rural schools and districts of varying sizes, coupled with shared challenges such as educating children in poverty, those with disabilities, English language learners and those with parents who move frequently.

Nebraska for decades has relied more heavily on local property taxes to fund schools than most other states – which has framed the debate over what is fair and equitable.

Meanwhile, the economy has changed markedly in the last 50 years and continues to do so, shifting the landscape on which the school funding debate takes place.

A number of questions are key to the school funding debate:

What is most important in Nebraska's school funding: equity in spending or adequacy in school district support? Do the disparities of curriculum offerings to students in schools across the state and disparities in per-pupil spending mean some students are not being provided an "adequate" education?

How can Nebraska create an education finance system that fosters quality, fairness and equity when some schools have four times as much property value per student as other schools? Should the state assume a larger role in K-12 finance and, in effect, reduce property tax reliance?

Or is more fundamental revision of the school funding system needed? Is property value an appropriate measure of community resources in today's economy, or is it time to look at determining the wealth of a school district based on income of its residents or some other measures?

How well positioned are we in Nebraska to meet the technology and infrastructure needs of students and school districts to compete in a global economy heading into the future?

A periodic review of the entire school finance system – to address changes in how children are taught, federal policies, and the availability of financial resources – would allow Nebraska to create a common statewide vision for education in Nebraska while maintaining strong local control of schools.

We hope this primer helps Nebraskans understand the current school funding system, how it came to be and the challenges the state faces in this arena. We also hope it has shown the perceived inequities from different points of view and can promote a better understanding of the unique challenges facing different types of schools, while helping Nebraskans find more common ground on this vital issue.

## Appendix A. 2012/13 Components of Need



**Basic Funding** – Determines how much a district should spend by placing it in a group of 20 similar- sized schools. Basic funding uses two-year-old actual expenditures, increased by a cost growth factor to determine the amount of this component.

**Poverty Allowance** – School districts that annually complete a Poverty Plan will qualify for this per-student allowance. A Poverty Plan contains the activities, curriculum and goals for educating students in poverty.

**Poverty Allowance Correction** – Schools that receive a poverty allowance must show actual expenditures for poverty or the school district will receive a reduction to its needs.

**Non-qualified Poverty Adjustment** – Schools that do not spend 50 percent of their prior year poverty allowance will not be able to participate in the poverty allowance for the next certification of state aid.

**Limited English Proficiency (LEP) Allowance** – School districts that annually complete an LEP Plan will qualify for this allowance. An LEP Plan contains the activities, curriculum and goals for educating students with limited English proficiency. The LEP allowance is determined based on a per-student factor.

**LEP Allowance Correction** – Schools that receive an LEP allowance must show actual expenditures for LEP or the school district will receive a reduction to its needs.

**Non-qualified LEP Adjustment** – Schools that do not spend 50 percent of their prior year LEP allowance will not be able to participate in the LEP allowance for the next certification of State Aid.

**Elementary Class Size Allowance** – This allowance reflects additional need for schools that have kindergarten through grade 3 class sizes between 10 and 20 students.<sup>28</sup>

**Focus School & Program Allowance** – School districts that are members of a learning community are the only school districts that may qualify for this allowance. There is one learning community in Nebraska, made up of the 11 school districts in Douglas and Sarpy counties.

**Summer School Allowance** – School districts that operate summer school for at least three hours a day for 12 days will qualify for this allowance. The allowance is calculated using a per-student factor.

**Special Receipts Allowance** – This includes receipts for special education, state wards of the court and the high ability learner curriculum program.



**Transportation Allowance** – This allowance is designed to recognize the additional costs associated with the transportation of students. The amount of this allowance is calculated based on actual transportation expenditures or route miles traveled.

**Elementary Site Allowance** – School districts with more than one elementary school that is more than seven miles from another elementary school may qualify for this allowance.

**Distance Education & Telecommunications Allowance** – This recognizes the transmission costs for providing distance education courses.

**Instructional Time Allowance** – A school district that has actual hours of teaching time greater than the statewide average may qualify for this allowance. The amount of this allowance is calculated on a per-student factor.<sup>29</sup>

**Teacher Education Allowance** – This allowance is designed to recognize teachers with advanced degrees.

**Averaging Adjustment** – School districts that levy more than \$1.00 per \$100 of property tax valuation and whose basic funding per formula student<sup>30</sup> is less than the statewide average qualify for this adjustment.<sup>31</sup>

**New School Adjustment** – A school district that builds a new school due to overcrowding may qualify for the adjustment. The amount of need calculated for this adjustment is based on the school district's basic funding per formula student.

**Student Growth Adjustment** – School districts that see an increase in enrollment may apply for this adjustment. The amount of need calculated for this adjustment is based on the K-12 estimated end-of-year student count and the school district's basic funding per formula student.

**Student Growth Adjustment Correction** – A school district that received a student growth adjustment will have an increase in need if the actual student growth was higher than the estimated student growth; or the school district will have a decrease in its need if the actual student growth was less than the estimated growth.

**Local Choice Adjustment** – This is a reduction in the needs of any school district that chooses to operate with less than 390 students. The amount of this adjustment is determined based on a per-student-factor.<sup>32</sup>

**Needs Stabilization** – To avoid a large increase or decrease in a school district's need, a school district may not have need that is less than 100 percent or greater than 112 percent of its prior year's need.

Footnotes

28 2012/13 was the last year for this allowance.

29 The Instructional Time Allowance will be phased out over a two-year period beginning with 2015/16 State Aid.

30 Basic funding per formula student is a school district's basic funding divided by its formula students.

31 The Averaging Adjustment was repealed for 2013/14 State Aid. The Averaging Adjustment is reinstated for 2014/15 State Aid but only applies to school districts with more than 900 formula students.

32 2012/13 was the last year for the local choice adjustment.

# Appendix B. 2012/13 Components of Resources



**Yield from Local Effort Rate** – A school district’s adjusted valuation multiplied by the Local Effort Rate (LER). The LER is a theoretical tax rate that is established by statute. The LER for 2012/13 was \$1.0395.

**Net Option Funding** – Students do not have to be educated in their resident district. They have the opportunity to choose (option into) another school. School districts that have more students choosing to attend their school will receive this resource. The amount of the resource is calculated on a statewide per-student factor.

**Allocated Income Tax Funds** – This is designed to include the money that residents of a school district pay in state income taxes. This resource meets one of the goals of LB1059 (1990).

**Other Actual Receipts** – This is based on actual local and state receipts reported by a school district on the Annual Financial Report. Receipts identified as other actual receipts are found in §79-108.01.

**Minimum Levy Adjustment** – A school district that has a general fund property tax levy less than 95 cents per \$100 of property tax valuation will receive this adjustment. The statutory maximum general fund property tax for levy is \$1.05 per \$100 of property tax valuation.

**Retirement Aid** – This resource reflects a school district’s salary percentage multiplied by \$15 million. The \$15 million is an annual amount for this component of resources.<sup>33</sup>

Footnotes

33 2013/14 is the last year for this Resource component.

## Appendix C. 2012/13 Expenditure Exclusions



**Infrastructure Damaged by Natural Disaster** – A school district may exceed the spending limit for building and other infrastructure damage due to a natural disaster. The State Board of Education must approve the use of this exclusion.

**Judgments Not Paid by Liability Insurance** – This exclusion is limited to the amount not paid by the liability insurance coverage of the school district for a judgment against it. The State Board of Education must approve the use of this exclusion.

**Retirement Incentive Plan & Staff Development Assistance** – Any school district that must cut staff because it has reorganized or unified – in the specific budget year – may budget for these costs outside of the spending limit. The State Board of Education must approve the use of this exclusion.

**Distance Education Courses** – Any amounts received from schools or educational service units for providing distance education courses. The State Board of Education must approve the use of this exclusion.

**School District Reorganization Incentive Payments** – Qualifying school districts may exceed the spending limit by the amount of the school district reorganization incentive payments. The State Board of Education must approve the use of this exclusion.

**Data Transmission Networks Exclusion** – The first-year costs associated with joining Network Nebraska are excluded from the expenditure lid. Network Nebraska maintains the statewide data transmission hardware and software for providing distance education. The State Board of Education must approve the use of this exclusion.

**Expenditures for Transfer of Land** – Costs incurred to pay another school district for the transfer of land through a school district reorganization or an annexation of land by another political subdivision.<sup>34</sup> The State Board of Education must approve the use of this exclusion.

**Voluntary Termination Agreements with Certificated Employees** – Amounts agreed to be paid to a certificated employee for a voluntary termination of employment. The State Board of Education must approve the use of this exclusion.

**Retirement Contribution Increase** – The additional costs incurred by a school district to pay its portion of an employee’s retirement contribution. This expires after 2016-17.<sup>35</sup> The State Board of Education must approve the use of this exclusion.

**New Elementary Attendance Site(s)** – A school district may exceed the spending limit for the first-year costs of operating a new elementary school. The State Board of Education must approve the use of this exclusion.

**Special Election to Override Expenditure Lid** – A school district may ask voters to exceed the spending limit through a special election. Effective for one fiscal year only.

Footnotes

34 This exclusion has been repealed and is no longer available.

35 The sunset provision for this exclusion has been repealed.

## Appendix D. 2012/13 Levy Exclusions



**Voluntary termination agreements with certificated employees** – Amounts to be paid to certificated employees in exchange for a voluntary termination of employment.

**Special Building Fund Projects** – Amounts to pay for special building fund projects started before April 1, 1996.

**Judgments not covered by liability insurance** – Any amount for judgments obtained against a school district that are not covered by liability insurance.

**Lease-purchase contracts approved prior to July 1, 1998** – The amount of any yearly lease payments for any active lease-purchase contracts.

**Bonded indebtedness** – The amount to retire the principal and interest on a bond that was approved by a vote of the taxpayers in the school district.

**Special Election to Override the Levy Lid** – A board of education or the patrons of a school district may call for a special election to exceed the levy limitation. The special election ballot must include the amount of the excess levy authority being sought and the number of years for the excess levy. A levy override may not exceed five consecutive school fiscal years.

# OpenSky Policy Institute: Clear Thinking for a Stronger Nebraska



OpenSky's mission is to improve opportunities for every Nebraskan by providing impartial and precise research, analysis, education, and leadership.

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