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A Question of Proportionality: Health Benefit Funding Restored for Community Colleges

On October 23, Gov. Rick Perry, Lt. Gov. David Dewhurst, and Speaker Tom Craddick announced an agreement to fully restore to public community colleges $154 million in fiscal 2009 funding for employee group insurance contributions that Gov. Perry earlier had line-item vetoed from the fiscal 2008-09 state budget. Community colleges will receive $99 million to pay for the state's share of health benefits for eligible community college employees and an additional one-time transitional payment of $55 million to address the health benefits of other employees.

State leaders did not specify the source of the funds, which will be allocated through a combination of budget execution authority or other existing transfer authority by September 1, 2008. Any funds used from another appropriated source could be restored through a supplemental appropriation when the 81st Legislature convenes in January 2009.

As agreed by the leadership, the definition of proportionality for purposes of state funding of community college employee health insurance benefits in the future will include only the proportion of employees paid with state funds.

The agreement also allows community colleges to be eligible for incentive funding that previously was available only to four-year institutions. Community colleges will have access to some of this funding if certain benchmarks are met, including increased graduation and transfer rates. Additionally, the governor will appoint a task force to study performance incentives and make recommendations to the 81st Legislature.

As part of their agreement, the state leaders asked community colleges to rescind tuition, fee, or tax increases designed to offset the fiscal 2009 funding originally vetoed by the governor. According to community college officials, less than ten colleges had raised their tuition and fees or had considered doing so because of the veto. For example, Austin Community

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Local Voters Asked to Approve Higher School Taxes

This fall, more than one hundred Texas school districts will ask local voters to approve school district taxes for maintenance and operations (M&O) higher than the reduced base rate adopted by the 79th Legislature in May 2006 as part of an overhaul of the state's school finance system.

According to the Comptroller's Property Tax Division, 14 districts already have held "tax rollback" elections this fall, with 11 ratifying higher M&O rates proposed by their school boards and three rejecting the higher rates (see chart on page 6). About 105 districts, including San Antonio ISD and San Marcos ISD, will seek similar approval in elections held November 6, 2007. These elections are called "tax rollback" elections because the tax rate will be rolled back to the base rate if voters do not approve the higher rate adopted by the local school board.

Most of the districts holding tax rollback elections in November are small, rural districts with relatively low property values. Over the next several years,

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College already had raised its general fee by $2 per semester credit hour, but now plans to rescind that increase. Other colleges will be able to reverse budget cuts that had been made because of the veto. However, community college officials note that any institution that had raised its rates or considered doing so because of the overall decline in state funding will still feel those funding pressures.

Community college officials around the state still have concerns about the potential for reduced state funding for employee health benefits after 2009. While they support incentive funding and welcome the opportunity to work toward the benchmark achievements, incentive funding cannot be used to pay employee benefits, and they feel the issue of base funding to pay for fixed costs still needs to be addressed. Community college officials say they are pleased that a short-term solution to the immediate crisis has been found and look forward to working with the task force and legislators to continue the discussion about paying for employee health benefits and community college funding in general.

The governor's veto

In June 2007, Gov. Perry exercised line-item veto authority to remove $154 million from the fiscal 2008-09 state budget (HB 1 by Chisum) that would have funded higher education employee group insurance contributions for public community colleges in fiscal 2009, the second year of the two-year budget. In his veto message, the governor said that these funds inappropriately would have allowed community colleges to use "millions of state dollars annually to pay the benefits of non-state paid employees," which he said was contrary to state law. The governor did not veto the $154 million for community college group insurance benefits appropriated by the Legislature for fiscal 2008, which began on September 1.

Community college officials insisted that their funding requests for employee benefits, which the Legislature included in the fiscal 2008-09 budget, were consistent with the law and the state's obligation to fund community colleges. Many said they would be forced to replace the vetoed funds through a combination of higher property taxes, tuition hikes, and program or staff cuts.

Community college administrators said that the issue of restoring health benefits funds had to be resolved one way or the other by mid-October so they would know whether or not to adjust their tax rates or tuition rates. One constraint faced by state leaders in crafting an interim funding solution to the community college employee health benefits issue has been how to redirect state funds appropriated for other purposes. Unlike recent budgets, the fiscal 2008-09 general appropriations act does not allow vetoed funds to be spent through budget execution authority. Under this authority, the governor and the Legislative Budget Board (LBB) can agree to shift already appropriated funds between agency programs or even between agencies, but may not appropriate new funds. The rainy day fund and budget surplus funds also are off limits because those funds are not appropriated.

What is proportionality?

Central to the debate about funding community college employee health benefits is the proportional cost-sharing between the state and the institutions, also known as "proportionality." It is the method used to define the state's obligation to pay for employee benefits. According to the Legislative Budget Board (LBB), proportionality is used to maximize balances in general revenue through the alignment of salary funding source with benefits funding source. This budgetary principle requires that payments for salaries and associated benefits be proportional to an institution's sources of income. In other words, the state's obligation to pay for benefits is limited to those employees whose salaries are paid with state general revenue.

While this principle is not expressed in statute, it has become a standard element in recent state budgets, including the fiscal 2008-09 general appropriations act. Rider language in art. 9, sec. 6.08(a) of HB 1 holds that "unless otherwise provided ... payment for benefits from appropriated funds, including 'local funds' and 'education and general funds,' ... shall be proportional to the source of funds." Sec. 6.08(b) goes on to say that unless otherwise specifically authorized, funds appropriated out of general revenue may not be used for employee benefit costs, or other indirect costs, associated with salaries or wages paid from a source other than general revenue.

The controversy lies in the interpretation of proportionality and determining which community college employees are eligible to have their group health insurance benefits paid by the state. All public higher education institutions and state agencies determine the proportional cost-sharing split for employee benefit costs. However, in the past, the Legislature has not applied proportional cost-sharing to fund the state's share of community college employee benefits.

History of community college funding

The community college formula funding system was introduced by the 63rd Legislature in 1973. Since its implementation, the arrangement between the state and local communities for the financing of community colleges has been based on shared costs. The governing board of each community college district levies ad valorem taxes to generate revenue for the funding of physical plant facilities, while the state funds the costs of education and administration. State funds are based on the number of hours that community colleges teach students, known as "contact hours." In addition to state appropriations and property taxes, the third major source of revenue for community colleges is student tuition and fees. Community colleges also receive private grants and donations, interest on investments, and some federal funding, mostly in the form of financial aid grants. There is a wide range of dependence on the revenue sources – some institutions rely heavily on local tax revenue, while others depend more on tuition and fees.

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Historically, community colleges have used state appropriations to fund the education of students, while using locally raised tax dollars to build and maintain buildings and physical facilities. After a 20-year period when state appropriations covered at least half of the costs of funding the community college system, since 1995 the state's share of revenue has declined steadily. Today, the state contributes about 31 percent of the total revenue, compared to about 68 percent in 1980.

Every other year, the Texas Higher Education Coordinating Board (THECB) makes formula rate recommendations to the Legislature based on a study of instructional programs and contact hours to determine the actual cost of instruction. For fiscal 2008-09, full formula funding would have been more than $3 billion. THECB recommended $2.3 billion, and the 80th Legislature appropriated $1.7 billion.

Group health insurance funding. Prior to 1978, community colleges paid for all employee benefits without any state support. From 1978 to 1991, the state provided appropriations for employee benefits for each eligible employee – faculty employed to teach at least 50 percent of the time for at least four months. Starting in 1991, the Legislature brought community colleges into the Employee Retirement System (ERS) group health insurance pool, which required colleges to provide health insurance benefits at no cost to their employees and retirees. The Legislature made eligible any employee compensated for services rendered to an institution of higher education and totally covered health insurance costs for these community college employees.

In the mid-1980s, the Legislature excluded employees whose salaries are paid with federal funds from state-funded group health care and required that their premiums be paid with federal funds. Similarly, because physical plant employees draw their salaries from local funds, the 78th Legislature in 2003 directed community colleges to pay the benefits of physical plant employees out of local funds.

Debate

Supporters of applying proportionality to state funds used to pay employee benefits point to the interpretation of state law and legislative intent held by the LBB and the Governor's Office. In 2005 and 2007, the LBB recommended to the Legislature that proportionality be applied to community colleges as a cost-saving measure. It found that community colleges are the only state entities receiving significant amounts of general revenue that do not apply proportionality to requests for health benefit funding. Instead, according to the LBB, community colleges use a "non-standard" method of requesting state funds that is not based on the source of the employee's salary, but rather on whether an employee performs occupational functions that are legally eligible to be funded with state general revenue appropriations. Community college officials have received specific instructions on how to calculate proportionality, and they must submit funding requests that conform to this well-established methodology.

Supporters contend that the disproportionate payment of employee benefits using state general revenue violates the general appropriations act and results in the inappropriate use of state funds. The state does not pay benefits for local employees such as county commissioners, they say, and the arrangement with regard to health insurance payments for local community college employees should be no different. While community colleges are essential to the higher education system in Texas and deserve sufficient funding to carry out their important mission, they nevertheless are required to follow the law and pay their fair share of health benefits costs in the same manner as other state entities.

Opponents of applying a "source-of-funds" application of proportionality say that community colleges already are in compliance with proportionality requirements in the context of the traditional cost-sharing arrangement between these institutions and the state. They say the source-of-funds interpretation of proportionality effectively penalizes community colleges for using other funds to meet the costs of educating students because, as the state's share of funding has decreased, community colleges have been forced to spend more of their locally generated funds on educational and administrative costs traditionally paid by the state. At the same time, community colleges have complied with instructions from the Legislature to remove physical plant employees and staff paid with local funds from state-funded group health coverage. To balance the equation, they say, the Legislature has recognized the special nature of community college funding and repeatedly has decided to "otherwise provide" general revenue funding for employee benefits without insisting on proportionality in the same manner that it applies to state agencies. After reviewing the LBB's recommendations in 2005 and 2007, the Legislature decided not to implement them and instead appropriated more than $300 million in health benefit funding for community college employees in fiscal 2008-09, which clearly demonstrates legislative intent, according to community college advocates.

Community colleges say that some of their employees eligible to be paid from state funds are paid from local funds because colleges have been using tuition and local tax dollars to fill the gap created by declining state funding. If the state increased its funding to community colleges, more employees would be eligible to have their benefits paid for by the state, which would mean that colleges would not have to consider enacting future tuition and tax increases or cut programs to ensure that funding for employee benefits is available.

According to the Texas Higher Education Coordinating Board (THECB), more than half the 1.2 million Texas students in higher education rely on junior and community colleges to provide an affordable, high-quality education. THECB says that community colleges will play an increasingly vital role in helping the state meet its higher education goals and predicts that as much as 70 percent of the state's higher education enrollment will be at community colleges by the year 2015. Advocates of increased funding say that the state must adequately support public community colleges to ensure that they remain affordable and accessible in order to meet the challenges that lie ahead.

Opponents of the interpretation of proportionality requirements favored by the governor say it fails to account for significant differences between community colleges and other state agencies, including four-year public institutions of higher education. For example, unlike for four-year institutions, the state does not fund social security contributions made by community colleges for their employees. In addition, the state reimburses health care costs at a lower rate for community colleges. The 80th Legislature appropriated only 90 percent of the actual health care costs for community colleges for fiscal 2008-09 while funding 95 percent of the health care costs for institutions in the University of Texas and Texas A&M systems. Further, opponents say, the Legislature funded 97.5 percent of health care costs for all other sectors of higher education within ERS. Community college advocates say that if the state wishes to expand the definition of proportionality to include community colleges, it should increase the formula funding, which would direct more state money toward paying educational costs and thereby increase the state's support for employee health benefits.

– by Rita Barr

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more districts are expected to follow suit in an effort to raise more local funds to cover such operating costs as salaries, health insurance, and energy costs.

While school districts routinely must seek voter approval to issue bonds for buildings and other long-term capital expenses, the requirement that voters approve increases in local taxes for operating costs was a significant element of the school finance changes adopted by the 79th Legislature in 2006 in HB 1 by Chisum.

Background

In November 2005, the Texas Supreme Court upheld a ruling by state District Judge John Dietz of Austin that school districts lacked "meaningful discretion" in setting their local M&O tax rates, effectively resulting in an unconstitutional state property tax. The court ordered the Legislature to remedy the constitutional infirmity in the school tax system by June 1, 2006, or else the court would enjoin the state from distributing funding for the public school system.

In its third called session in 2006, the 79th Legislature enacted HB 1 by Chisum, which provided for state aid to school districts to reduce school M&O property taxes by one third in tax year 2007 and beyond. For districts taxing at the maximum M&O rate of $1.50 per $100 of valuation, the base rate dropped to $1.00, based on a compression rate of two-thirds of the district's 2005 tax rate. The lower rate was phased in, with an initial reduction of 11.3 percent, lowering the M&O tax rate to $1.33 for the 2006 tax year for those districts taxing at the previous maximum of $1.50.

School districts were given the discretion to levy up to 4 cents per $100 beyond the base M&O tax rate in "enrichment" taxes without voter approval. Any additional enrichment taxes must be approved by district voters in a local election.

Besides setting its actual M&O rate, a school district also must calculate its "effective" tax rate, which generally is the rate that would raise the same amount of money using the current year's taxable property wealth base as the past year's actual tax rate generated using the past year's property wealth base. For example, if the value of the district's property wealth base increased, then its effective tax rate would be lower than its actual tax rate.

Beginning with the 2007 tax year, a school district's effective tax rate will be one of the factors used to determine tax rates. Maximum tax rates will be the lesser of two calculated values. The first is the sum of the compression percentage multiplied by $1.50, plus 4 cents, plus the cumulative pennies of rates previously approved by voters, plus the district's current debt rate. The second is the district's effective M&O tax rate, plus 4 cents, plus the current debt rate. Any rate set beyond the maximum rate must be approved by voters in a rollback election. If voters refuse to ratify the higher rate, it is "rolled back" to the maximum allowable rate.

Tax increase proposals

Most districts adopt 4-cent increase. According to the Comptroller's Office, for the 2006 tax year, 973 of the state's 1041 school districts took advantage of the option to increase local M&O tax rates between 2 and 4 cents without voter approval, with most districts opting for the maximum 4-cent increase. School districts receive guaranteed state funding for this additional tax effort at a rate of about $46 per penny per "weighted" student, meaning that if the district's property value per student does not yield this amount of revenue, the state will make up the difference. For any tax effort beyond the 4 cents, districts receive a guaranteed yield of about $32 per penny per weighted student.

Because the 4 cents of additional local tax effort generates significantly more state aid, some refer to them as "golden pennies." Also, districts with the highest property wealth per student get to keep all the revenue generated by the "golden pennies" without it being "recaptured" by the state. In the 2008-09 school year, the number of "golden pennies" will increase to 6 cents of local tax effort beyond the basic compressed tax rate.

For most school districts, tax rates that include from two to four "golden pennies" are expected to generate sufficient state and local funding to meet budgetary needs in 2006 and

2007 School District Tax Rate Rollback Elections Already Held

TAXING UNIT	COUNTY	ELECTION RESULTS	2007 PROPOSED TAX RATE *	ROLLBACK RATE/ % INCREASE *	ELECTION DATE
Abbott ISD	Hill	**Ratified** For – 111 Against – 14	1.15	1.0785/ 7%	9/29/2007
Axtell ISD	McLennan	**Ratified** For – 49 Against – 5	1.17	1.04/ 12%	10/6/2007
Boles ISD	Hunt	**Ratified** For – 18 Against – 2	1.253	1.1229/ 10%	10/13/2007
Bruceville-Eddy ISD	McLennen	**Ratified** For – 40 Against – 6	1.325	1.195/ 11%	10/6/2007
Crowell ISD	Foard	**Ratified** For – 185 Against – 5	1.17	.9467/ 24%	10/6/2007
Lytle ISD	Atascosa	**Against ratification** Against – 171 For – 105	1.22 (rejected rate: 1.40)	1.22/ 15%	10/13/2007
Maud ISD	Bowie	**Ratified** For – 141 Against – 110	1.22	1.09/ 12%	10/6/2007
Nacogdoches ISD	Nacogdoches	**Ratified** For – 1,131 Against – 697	1.37	1.24/ 10%	9/15/2007
Poteet ISD	Atascosa	**Against ratification** Against – 129 For – 85	1.125 (rejected rate: 1.255)	1.125/ 12%	10/13/2007
Redwater ISD	Bowie	**Ratified** For – 391 Against – 256	1.29	1.16/ 11%	10/6/2007
Schulenburg ISD	Fayette	**Against ratification** Against – 431 For – 206	1.23 (rejected rate: 1.36)	1.23/ 11%	10/6/2007
Tulia ISD	Swisher	**Ratified** For – 235 Against – 16	1.16	1.04/ 12%	9/22/2007
Whitesboro ISD	Grayson	**Ratified** For – 332 Against – 154	1.337	1.207/ 11%	10/6/2007
Ysleta ISD	El Paso	**Ratified** For – 2,308 Against – 2,013	1.33	1.20/ 11%	10/8/2007

Source: *Survery of 2007 Tax Rate Rollback Activity*, Comptroller of Public Accounts, Property Tax Division
*The tax rates include both the maintenance and operations rate and the debt rate.

2007. But for the 2008 tax year and beyond, many more districts are considered likely to seek voter approval for higher local tax rates.

Some districts seek maximum rate. This November, many districts holding rollback elections are asking voters to approve the maximum allowable M&O tax rate of $1.17 per $100 of valuation. Supporters of the higher rate say it is needed to generate necessary revenue to maintain school operations and that while taxpayers would receive more limited tax relief than the amount approved by the Legislature in HB 1, they still would experience significant tax reduction compared to the 2005 and 2006 M&O rates. Opponents say that the higher proposed tax rates would prevent taxpayers from receiving the full benefit of the local property tax reduction approved by the Legislature and that a higher tax rate combined with increasing property values will mean that the amount of their school tax bill soon could creep back up to what it was before.

Those districts that secure voter approval for a tax increase in 2007 also will qualify for additional state aid that will be generated when the maximum number of enrichment "golden pennies" increases from four to six in the 2008-09 school year.

– by Betsy Blair

HOUSE RESEARCH ORGANIZATION

John H. Reagan Building
Room 420
P.O. Box 2910
Austin, Texas 78768-2910

(512) 463-0752

www.hro.house.state.tx.us