LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 78TH LEGISLATURE 4TH CALLED SESSION - 2004

April 21, 2004

TO: Honorable Kent Grusendorf, Chair, House Committee on Public School Finance, Select

FROM: John Keel, Director, Legislative Budget Board

IN RE: **HB1** by Grusendorf (Relating to public education and public school finance, including state and local taxation.), **As Introduced**

Estimated Two-year Net Impact to General Revenue Related Funds for HB1, As Introduced: a negative impact of ($2,606,829,000) through the biennium ending August 31, 2005.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2005	($2,606,829,000)
2006	($2,662,431,000)
2007	($2,935,257,000)
2008	($3,427,503,000)
2009	($3,818,853,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue Gain/(Loss) from *GENERAL REVENUE FUND* 1	Probable Savings/ (Cost) from *GENERAL REVENUE FUND* 1	Probable Revenue Gain/(Loss) from *FOUNDATION SCHOOL FUND* 193	Probable Savings/ (Cost) from *FOUNDATION SCHOOL FUND* 193
2005	($1,815,739,000)	($354,000,000)	$549,110,000	($986,200,000)
2006	($1,982,174,000)	($361,000,000)	$835,443,000	($1,154,700,000)
2007	($2,182,135,000)	($368,000,000)	$891,178,000	($1,276,300,000)
2008	($2,331,926,000)	($376,000,000)	$762,623,000	($1,482,200,000)
2009	($2,590,798,000)	($384,000,000)	$827,745,000	($1,671,800,000)

Fiscal Year	Probable Savings/ (Cost) from *LOTTERY ACCT 5025*	Probable Revenue Gain/(Loss) from *New General Revenue Dedicated - Education Excellence Fund*	Probable Revenue Gain/(Loss) from *Cities*	Probable Revenue Gain/(Loss) from *Counties*
2005	($26,431,160)	$186,054,000	$10,015,000	$1,249,000
2006	($57,182,520)	$508,051,000	($1,836,000)	($18,652,000)
2007	($61,502,721)	$639,955,000	($22,100,000)	($38,214,000)
2008	($64,033,100)	$761,144,000	($62,455,000)	($75,997,000)
2009	($66,676,221)	$905,173,000	($109,452,000)	($119,420,000)

Fiscal Year	Probable Revenue Gain/(Loss) from *School Districts*	Probable Revenue Gain/(Loss) from *Transit Authorities*	Change in Number of State Employees from FY 2004
2005	$0	$3,438,000	11.0
2006	($87,707,000)	$7,226,000	22.0
2007	($77,260,000)	$7,660,000	22.0
2008	($145,317,000)	$8,120,000	22.0
2009	($160,410,000)	$8,607,000	22.0

Fiscal Analysis

The bill amends the current law school finance system and current state taxes.

Section 1 of the bill establishes an educator excellence system which ranks school campuses based on value-added student achievement, and distributes per-teacher grants to eligible teachers to the highest ranked campuses. For campuses ranked in the top quintile (representing 20% of statewide student enrollment), each eligible classroom teacher in those campuses is entitled to an incentive payment of between $3,000 and $5,000. Eligible principals at these first-tier campuses would receive $10,000. Eligible teachers in campuses that fall into the second-highest performance quintile (representing the next 20% of enrollment) would receive between $1,000 and $2,000. Eligible principals at these second-tier campuses would receive $5,000.

Sections 2 and 3 of the bill replace the current exit-level TAKS assessment with end-of-course examinations in a variety of subject areas. Beginning with students graduating in the 2009-2010 school year, receipt of a high school diploma will depend upon satisfactory performance on end-of-course assessments for English III, United States History, two mathematics assessments, two science assessments, one of the first two English assessments and one of the history/geography assessments. For students graduating during or before 2008-2009, assessment using the end-of-course examinations will be at local district discretion and will not be a requirement of graduation. Based on the effective date of the bill of January 1, 2005, the current requirement for satisfactory performance on the exit-level TAKS assessment would be removed beginning with the 2004-2005 school year, provided that the constitutional amendment associated with other provisions of the bill is approved by voters.

Sections 4-7 of the bill modify the current law funding formulas. The basic allotment is increased to $2650, the guaranteed yield is increased to $27.50 per penny of tax effort, the maximum tax rate for the Tier II guaranteed yield is decreased from $0.64 to $0.44 and the guaranteed yield for the Instructional Facilities Allotment is increased to $35.50 per penny of tax effort.

Section 8 establishes a video lottery revenue source.

Section 9 establishes a 3 percent limitation on the annual increase in homestead property valuation.

Sections 10 and 11 revise the calcuation of the tax rollback limit for most non-school district taxing jurisdictions and allow for a 3 percent increase in the rollback rate.

Sections 12 and 13 amend Section 151.0031 of the Tax Code by defining a "computer program" to include a computer program created or developed exclusively for a client who retains all rights to the program and would tax such programs under sales tax law, Section 151.0101 of the Tax Code.

Sections 14 and 15 increase the tax on cigarettes and modify the distribution of cigarette tax revenue.

Section 16 repeals a number of existing statues:

(1) Chapter 41 of the Texas Education Code is repealed (relating to wealth equalization);
(2) Subchapter H of Chapter 21 of the TEC is repealed (relating to teacher appraisal);

(3) TEC Section 4.003 is repealed, relating to equalization within the Foundation School Program;
(4) Article 3.50-8 of the Insurance Code is repealed;

(5) The franchise tax is repealed; and,
(6)Certain language relating to rollback tax rates for water districts are repealed.

Section 17 continues the franchise tax provisions related to existing liabilities.

Section 18 establishes an effective date of January 1, 2005 for the entire bill, contingent on passage of a related joint resolution.

Methodology

Teacher Incentives and Student Assessment

This note assumes that the average teacher incentive award amount in the top tier is $4,000. It also assumes that the highest-rated campuses that comprise 20% of the state's students also represent 20% of the state's teachers, or a projected 60,000 for the 2004-05 school year (based on 2002-03 actual number multiplied by the average annual growth rate of 2.5% for two years). This yields a state cost for the 2004-05 school year of $240 million. Assuming the average award amount in the second tier is $1,500 per teacher, the estimated cost of the second tier awards is $90 million.

For the incentive awards for principals, it is assumed that campuses representing 20% of the state student population will also represent 20% of campuses, or 1,600 for the 2004-05 school year (based on the 2002-03 actual number of campuses multiplied by the average annual growth rate in campuses of 1.5%). The state cost of the $10,000 top tier awards would be $16 million, and the $5,000 second tier costs would be $8 million.

The total estimated cost to the state in the 2004-05 school year of the incentive program is $354 million. After the 2004-05 school year, as the number of teachers and principals increases by an estimated 2% each year, the annual costs are estimated to increase commensurately.

Elimination of the current TAKS exit-level exam would yield an estimated savings of $7.4 million annually. Based on costs of end-of-course tests previously administered by Texas ending in the 2002-03 school year, the addition of end-of-course tests in these subjects would cost approximately $28 million, yielding a net annual cost of $20.6 million. However, assessment costs currently are paid for using federal funds to the extent available and, should those funds be insufficient, with a set-aside from the Foundation School Program. Therefore, there would be no net cost to the state.
Foundation School Program

While the effective date of the bill is January 1, 2005 it is assumed that the changes to school district entitlements impact the entire fiscal year 2005.

The bill increases the funding formulas for the calulation of state aid entitlements but also decreases the maximum tax rate used for state aid calculation purposes. The net impact is a decrease in state aid paid to school dsitricts relative to current law. The change to the Basic Allotment increases state aid by about $560 million per year, but the net impact of the increase to the Guaranteed Yield coupled with the decrease in maximum tax rate results in reduced state aid of about $700 million per year. The elimination of recapture (repeal of Chapter 41) increases state costs by $1.1 billion in 2005 increasing to $1.6 billion in 2008. The increase to the Instructional Facilities Allotment yield is eatimated to cost the state $5 million annually, and their is an increase to the cost of the Chapter 42.2514 (b) insurance benefit hold harmless of about $6 million annually as a result of the formula changes.

The impact of the repeal of Article 3.50-8 of the Insurance Code is ambiguous. That section of law does not exist under current codification of the Code. If the intent of the repealer is to reinstate the $1,000 school district employee pass-through in fiscal year 2005, there would be a cost to the state in 2005. Note that current law reinstates that pass-though amount in 2006.

Revenue Provisions

The estimated fiscal impact relating to video lottery terminals (VLT's) was based on class I or class II pari-mutuel horse tracks, greyhound racing tracks and the assumption that the Tigua, Kickapoo, and Alabama-Coushatta Indian tribes would be eligible and licensed to operate video lottery terminals. The estimate was made assuming a 50 percent split for VLTs and 25/75 percent split for Native American tribes. As no appropriations would be made in the bill, the analysis does not assume any additional administrative funding for the commission. The Comptroller's Office estimates first full year revenue (fiscal year 2006) of $508 million growing to $905 million by fiscal year 2009. The Texas Lottery Commission estimates expenses of $57 million in fiscal year 2006 growing to $67 million in fiscal year 2009 and the hiring of 22 additional employees beginning fiscal year 2006.

With respect to lowering the limit on the maximum growth in the appraised value of residence homesteads to 3 percent from 10 percent per year since the last reappraisal, the estimate was based on 2002 and 2003 appraisal roll information reported electronically by appraisal districts. The percent change in value from tax year 2002 to 2003 for each of 4.7 million residences listed on the appraisal roll in both years was calculated, and the results were sorted by percent change. The value loss resulting from the proposed limitation was calculated for properties that increased in value more than 3 percent (value losses to the existing 10 percent value limitation were excluded from the cost estimate of lowering the cap).

The value loss was adjusted to account for lower projected future growth rates for residential property, and further adjusted in the second and succeeding years of the analysis to reflect multi-year appraisal cycles and the holdover of capped property from one year to the next based on historical data from the existing 10 percent cap. The projected city, county, and school district tax rates were applied to the value losses in each year to estimate their respective levy losses. Because of the operation of the school funding formula, school district losses would be incurred by the state after a one-year lag. After the first year, school districts would incur only each year's incremental loss. The Comptroller's Office estimates a loss of revenue to the state in fiscal year 2007 of $88 million growing to $310 million by fiscal year 2009.

With respect to the provisions amending Tax Code Chapter 151, under current law, mass produced computer programs generally sold through retail outlets are subject to sales tax. Contract programming services for the development and maintenance of unique programs are not included in the definition of taxable services and are excluded from taxation. This bill would eliminate that exclusion. Data on the sale of contract computer programming services in Texas were gathered from the U.S. Census Bureau. Sales were multiplied by the sales tax rate, adjusted for an effective date of January 1, 2005, and extrapolated through 2009. The fiscal impact on units of local government was estimated proportionally. The Comptroller's Office estimates first full year revenue to the state (fiscal year 2006) of $112 million growing to $133 million by fiscal year 2009.

The proposed increase in the cigarette tax rate would have a downward effect on the taxable consumption of cigarettes in Texas. Potential revenue collections were adjusted for consumption and tax avoidance effects and for collection lags. Because taxable cigarette consumption would decline and the Fund 0001 allocation from the cigarette tax would remain at the current 41 cents per pack, there would be a net loss of cigarette tax revenue allocated to Fund 0001. This analysis also assumed that allocations to the Foundation School Fund 0193 would begin when the new tax revenue reached the State Treasury, which would be approximately one month following the effective date. The Comptroller's Office estimates first full year revenue (fiscal year 2006) of $746 million decreasing to $711 million by fiscal year 2009.

With respect to the repeal of Tax Code Chapter 171, the estimate assumes that no franchise tax reports or payments would be required for reports that would have been due on or after January 1, 2005. This would include the 2005 regular report and final reports that would have been due after the effective date of the bill. Franchise payments and refunds made after the effective date would be based on tax liability incurred on a report originally due before the effective date of the bill. The Comptroller's Office estimates a loss of revenue to the state in fiscal year 2005 of $1.8 billion growing to $2.3 billion by fiscal year 2009.

Note: This legislation would do one or more of the following: create or recreate a dedicated account in the General Revenue Fund, create or recreate a special or trust fund either with or outside of the Treasury, or create a dedicated revenue source. Therefore, the fund, account, or revenue dedication included in this bill would be subject to funds consolidation review by the current Legislature.

Local Government Impact

The provisions of this bill will impact local school district operations and access to revenues.

To the extent that assessment costs charged to the compensatory education allotment could increase due to the replacement of the exit-level TAKS with the proposed series of end-of-course assessments, the amount of funding distributed to school districts through the compensatory education allotment could decrease.

As a result of the new limitation on recognized Tier II tax effort, state aid to many school districts would be reduced. This would be offset to the extent districts recieve excellence incentives. All current law Chapter 41 school dsitricts would gain revenues under the provisions of the bill.

The bill does not appear to limit local tax rates (only the rate recognized by the state for Tier II). It is likely that some local tax rates would increase to compensate for that loss of state aid. It is also possible that tax rates for current law Chapter 41 districts could decrease as a result of their increased access to local revenues.

Local governments would realize a revenue gain from the sales tax provisions and losses from the appraisal limitation, noted in the above tables.

Source Agencies: 304 Comptroller of Public Accounts, 362 Texas Lottery Commission, 476 Racing Commission, 701 Central Education Agency

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