



Local Revenues for Schools: Limits and Options in California

HIGHLIGHTS

- Locally generated revenues are a very small portion of school funding, and the amounts vary dramatically by community 2
- A lawsuit concerned with funding inequities and an initiative aimed at controlling property tax increases in large part created today's state-controlled school finance system 4
- Diverse stakeholders are discussing ways to allow communities to raise more funds for their schools, including changes to Proposition 13..... 6
- Local revenue options should be part of larger discussions about how to fix the state's budget process 7

Throughout the chaos that has characterized California's budget process in recent years, education funding has been a central issue. K–12 schools represent the single largest expenditure in the state budget. As a result, they are seen by some as a major drain on state coffers and by others as the hardest hit victims of the state's fiscal meltdown.

California's schools have sustained significant funding cuts since 2007, yet substantial evidence indicates that Californians do not want to see cuts to their schools. Despite an extraordinarily difficult economy in the fall of 2008, the vast majority of state residents who were asked to raise their own taxes in support of local schools agreed to do so.

But California law severely limits local school districts' revenue-raising authority compared with most other states and compared with what was possible here prior to 1972. Decisions made in the 1970s also shifted control of school funding to the state. Many believe these changes eroded the connection between schools and their communities and

help explain why California today funds its schools well below the national average. But proposals to make it easier for local communities to increase funds for their schools raise concern among both tax opponents and social justice groups. The latter worry that easing fundraising restrictions without considering equity issues might disproportionately advantage wealthier neighborhoods and exacerbate an already substantial gap between the academic performance of students from low- and high-income families.

This brief provides background on California school districts' current options for raising their own revenues and describes some ways to expand their ability to do so.

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Districts are limited in generating additional revenues for school operations

Under current state law, districts can augment the local funding of their schools in just a few ways, most notably private donations, parcel taxes, and the seldom-used sales tax. Taken together, these revenue sources currently generate a very small portion of total K–12 funding in the state, but in some communities they provide substantial amounts per pupil.

Private monetary and in-kind contributions are unofficial revenue sources

The state puts almost no limitations on the amount and use of private donations to public schools. Information about the precise amount of money raised through private contributions is not available, though two sources provide some perspective.

The California Consortium of Education Foundations (CCEF) reports that the state has more than 600 foundations, which together raised more than \$150 million in 2007. Found in most California counties, these foundations can be countywide, districtwide, or in a single school.

The Ed-Data Partnership website, which compiles revenue data as reported by school districts, also provides information on local contributions. In the “all other local revenue” category, which includes donations and

several other sources, the statewide total in 2007–08 was \$953 million, or about \$163 per student on average (based on average daily attendance or ADA). This amount is dwarfed by the \$53.3 billion general fund revenues reported by districts. In addition, the amount per district varied substantially. A very small number of districts reported more than \$1,000 per pupil, while other districts recorded no revenues. For some schools and districts, in-kind contributions of equipment, materials, or volunteer hours also represent substantial supplementary resources, much of which goes unreported.

In some districts, parcel taxes have been an important mechanism for local revenue enhancement

Communities can also raise funds for their school districts by approving a tax on parcels

of land by a two-thirds vote. California is the only state that allows parcel taxes as a method of funding schools, according to a 2007 report by researchers William Duncombe and John Yinger.

Most parcel taxes assess a flat fee on each parcel of property, no matter what its size or value. Prior to the passage of Proposition 13 in 1978, they were expressly forbidden by the state constitution. Property had to be taxed in proportion to its full value. Proposition 13 severely constrained the growth of property taxes, but it allowed local governments, including school districts, to pass a new “non-ad valorem” tax (not based on the value of property) if they received approval from two-thirds of voters.

Some consider parcel taxes that charge a uniform fee to be regressive because property owners typically pay the same amount regardless of the value of their property. Since 2001, at least eight school districts have passed parcel tax measures that established separate rates based on square footage or other property improvements. The other concern about parcel taxes is that their yield does not increase over time, while district costs generally keep rising. At least two school districts since 2007 have built an annual inflation increase into their tax rate.

When holding parcel tax elections, districts must declare the specific purposes of the tax. Parcel taxes generally remain in effect for three to ten years, but the timeframe can be longer, even permanent. State law requires the district’s chief financial officer to report annually to its school board on the amount of funds collected and spent as well as the status of any project called for in the measure.

The state largely controls the revenues school districts receive

Funding for school operations comes from several sources, only one of which is under the control of California’s local school districts.

- **59%—State General Fund**, which is fed mainly by income, sales, corporate, and capital gains taxes.
- **23%—Property taxes**, which are collected by counties. The state determines how to allocate them among school districts and other local governments. The tax rate is set in the state constitution.
- **10%—Federal government**, which generally provides only categorical funding (money earmarked for specific purposes, such as compensatory education for low-income students). The state distributes most of this funding. The recent stimulus package has temporarily increased the federal share.
- **1% to 2%—State lottery.**
- **7% to 8%—Local miscellaneous sources**, such as donations to local schools, interest income, and parcel taxes. Local school districts and their communities largely control these revenue sources. The amounts vary dramatically from one district to another.

Note: The percentages may not add up to 100% due to rounding.

Although all districts can propose a parcel tax to their community, they are relatively rare in most of the state. Between 2001 and June 2009, out of roughly 980 California school districts, 132 conducted parcel tax elections and 83 districts passed them. Only seven of those districts were located in Southern California, while 66 were within the nine-county San Francisco Bay Area. The districts that had successful elections generally serve fewer low-income students than the typical California school district. They are also disproportionately small, with 66 (80%) of them serving fewer than 10,000 students. (See Figure 1 for examples of exceptions.) In 2007–08, those districts that had parcel tax income reported total revenues of \$200 million, according to Ed-Data.

The combination of parcel tax rate and number of students determines the level of per-pupil revenues a district can raise. The variations in 2007–08 were striking:

- In Alum Rock Union, where 90% of students are low-income, a \$100 per parcel tax with an inflation adjustment provided \$161 per student (ADA).
- In West Contra Costa—one of four districts with more than 25,000 students that have passed parcel taxes—a tax rate of \$0.72 per square foot raised \$340 per student. About 62% of students in this district are low-income.
- In San Marino Unified, a small district in Los Angeles County with almost no low-income students, a \$795 per parcel tax raised \$472 per student.

One county has increased its local sales tax to help its schools

State law also allows communities to supplement school revenues by increasing their local sales tax. This requires a two-thirds vote and can be done only at the county level. In cases where the school district and county boundaries are the same—for example, San Francisco Unified School District—a county sales tax increase benefits only one district. In most of California’s 58 counties, a county sales tax would require school districts and the county government to cooperate and agree on the allocation of revenues.

figure 1 | Altogether 83 districts passed parcel taxes between 2001 and June 2009

The typical district was located in the San Francisco Bay Area and had about 3,180 students of whom 15% qualified for free/reduced-price meals (F/RPM) and 9% were English learners (ELs).*				
A sample of a few of the districts that serve high proportions of low-income and EL students				
District Name	Enrollment	% F/RPM*	% EL*	Parcel Tax Rate and Term
La Honda–Pescadero Unified	372	53.2%	47.3%	\$100/parcel–7 yrs
Santa Barbara Elementary	5,640	60.5%	47.0%	\$27/parcel–4 yrs
Franklin–McKinley Elementary	9,957	72.7%	60.3%	\$72/parcel–9 yrs
Ravenswood City Elementary	4,936	79.2%	60.7%	\$98/parcel–5 yrs
Alum Rock Union	13,841	90.3%	56.4%	\$100/parcel–5 yrs–adjusted for inflation
Four districts have more than 25,000 students				
San Ramon Valley Unified	25,959	2.0%	4.4%	\$144/parcel–7 yrs
West Contra Costa Unified	30,830	62.4%	33.8%	\$.072 per sq. ft. of total bldg area or \$7.20 per vacant parcel–5 yrs
Oakland Unified	46,431	68.5%	30.0%	\$195/parcel
San Francisco Unified	55,069	53.8%	29.5%	\$198/parcel–20 yrs–adjusted for inflation
Some districts assess particularly high amounts per parcel				
Piedmont City Unified	2,552	0.3%	3.7%	From \$1,200 per multifamily unit to \$3,065 for a lot over 20,000 sq. ft.; separate rates for commercial
San Marino Unified	3,199	1.0%	4.6%	\$795/parcel–6 yrs
Kentfield Elementary	1,001	0.0%	2.4%	From \$773.94 to \$12,945 per parcel–10 yrs with annual 5% COLA
Ross Elementary	374	0.0%	0.8%	\$626.98/parcel–8 yrs with annual 3% COLA

*Based on medians for the 83 districts. All demographic data are for 2007–08.

Since 1983, three counties have attempted to increase the local sales tax rate to aid schools—Mariposa (twice), San Francisco, and San Mateo. Only San Francisco succeeded, passing a quarter-cent increase in June 1993 with 74% approval. Mariposa’s two

Districts can raise funds for some specific purposes

State law allows school districts to generate revenues in two other significant ways, but neither can be used for general operating costs.

Districts often raise funds for facilities by approving local bonds

School districts' most significant revenue-raising opportunity relates to facilities only. Districts can issue general obligation bonds to build or renovate facilities with the approval of two-thirds of local voters or just 55% if they meet specific conditions related to the election and public oversight. They levy an ad-valorem tax to pay back those bonds. Districts could begin passing bond measures with 55% voter approval in 2001. Since then, 83% of these elections have passed, generating more than \$51.5 billion in facility funds for the state's schools.

About 39% of districts—in all but five counties—have passed at least one bond. They include districts of all sizes and types, serving students from a wide variety of backgrounds. Districts often use these funds to meet a matching requirement and qualify for state facility funds.

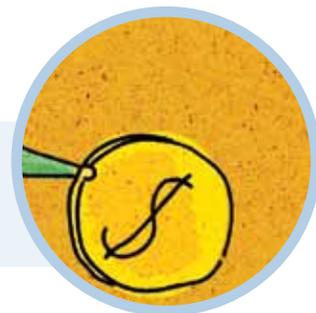
User fees help cover costs of extracurricular activities but may not be used for course-related expenses

In 1984, the state Supreme Court ruled in *Hartzell v. Connell* that school districts could not assess user fees for activities closely linked to classes. For example, schools cannot charge students to take part in a noncredit musical performance associated with a for-credit music class in which students rehearse for the performance. However, districts can—and often do—assess fees for activities that are not directly related to a class, such as athletics and transportation.

attempts both garnered more than 55% approval but fell short of the required two-thirds. Only 28% of San Mateo's voters supported a sales tax increase for schools.

Sales taxes have two notable features. First, sales tax revenue—which fluctuates in tandem with general economic conditions—is more volatile than property tax funding. Second, sales taxes are regressive, having a disproportionate impact on poor consumers, who spend a greater percentage of their incomes on sales taxes. Exempting some items, such as food and medicine, from a sales tax can make the tax less regressive but also less stable. Five other states allow school districts to levy some sort of sales tax: Louisiana, Tennessee, Alabama, Alaska, and Virginia.

Districts could largely determine their property tax revenues before *Serrano v. Priest* and Proposition 13



California's current school finance system began taking shape in the late 1960s and was solidified in the late 1970s. Before that, school districts received the bulk of their funding through local property taxes. Districts could set their own property tax rates within broad limitations. Majority votes of the local electorate were required for property tax increases above certain, state-specified levels. Districts with similar tax rates could have very different revenues per pupil because of differences in the assessed value of property in those areas or in the number of students they served. These differences became the subject of the *Serrano v. Priest* court case, which began in 1968.

Serrano v. Priest challenged inequities caused by differences in property wealth

The *Serrano* case was one of the first lawsuits to challenge the U.S. tradition of using property taxes as the principal source of revenue for public schools. Lawyers for the plaintiffs maintained that wealth-related revenue disparities among school districts violated

the "equal protection" clause of the state constitution. In this case, wealth was a product of the assessed value of district properties divided by the number of schoolchildren in the district.

In 1971, the California Supreme Court ruled in *Serrano* that education was a "fundamental interest" of the state and remanded

the case back to lower courts to determine whether the discrepancies described by the plaintiffs existed.

Anticipating an outcome that would demand that funding be equalized among districts, state leaders passed Senate Bill (SB) 90 in 1972, creating the "revenue limit" system that put a ceiling on the amount of

general purpose money each district could raise. (State and federal categorical funding—which is allocated based on specific students or programs—was not included in this equalization effort.) To achieve equalization, the Legislature then implemented a sliding scale of increases to revenue limits designed to bring lower-spending districts up to the level of higher-spending ones over time (labeled “leveling up”).

A second case, referred to at the time as *Serrano II*, was settled in 1976. The court ruled that the changes made with SB 90 were not enough. In 1977, the state passed Assembly Bill (AB) 65, which made further changes in the system using a “power equalization” plan that would redistribute state aid based on differences in district property tax revenues per pupil.

With the passage of Proposition 13, the state took control of school revenues

Voters passed Proposition 13 nine months later, in June 1978. The initiative’s supporters sought, among other things, to protect property owners by reducing and stabilizing their property tax obligations. Proposition 13 limited the property tax rate to 1% of assessed value and capped increases in assessed value at 2% or the percentage growth in the state’s Consumer Price Index, whichever is less. (However, if owners sell or remodel their individual properties, the assessed value is raised commensurately, and the capped annual increases continue from the new assessed value.) Proposition 13’s provisions wiped out more than half of local property tax revenues and therefore invalidated much of AB 65’s financial reform, including power equalization.

The Legislature’s “bailout” bill, SB 154 in 1978, retained the revenue limits but replaced most of the lost property tax dollars with money from the state budget to substantially mitigate districts’ revenue losses. In the process, the state also took control of the distribution of property tax revenues among local governments. High-revenue districts received smaller revenue limit increases than low-revenue districts on a sliding scale. This “squeezing” minimized the sudden drain on the state’s budget. AB 8, passed in

School districts had control over local property taxes from 1910 until 1978

Senate Bill 154—passed in 1978 in response to the *Serrano v. Priest* court case and Proposition 13—ended local governments’ control of property tax revenues that had been secured in 1910, when California voters approved the Separation of Sources Act. That measure granted local government exclusive control over property taxes, the main public revenue source at that time, according to a 2007 report from researcher Elisa Barbour.

Some districts are able to keep excess local property tax revenues

Under the current system, each district still has a revenue limit that is based on the formula the state first created in 1972, but which has been modified repeatedly since. For each district, that formula determines the amount of general purpose funding it receives per student (based on average daily attendance).

Revenue limit funds are a combination of local property taxes and state funds. The property taxes are allocated to schools first, then the state makes up the difference. Some districts, however, have local property taxes that exceed their revenue limit. Those districts are allowed to keep all their local property taxes, including the amount above the revenue limit. They are called “excess revenue” or “basic aid” districts.

Fluctuations in state funding and local enrollments mean that the roster of excess revenue districts shifts from year to year. In a typical year, at least 60 districts fit this description, many of which have a very small number of students. For some, the amount of property tax per pupil is quite substantial. In 2008–09, reductions in revenue limit funding pushed many more districts into excess revenue status. For those districts, the property taxes they receive in excess of their revenue limit will likely be quite modest.

the summer of 1979, continued the revenue limit system, including the squeeze mechanism for granting differential increases to districts based on their revenue limits. In 1983, the court ruled that the equity complaints brought in the *Serrano* case had been satisfied, and the case was officially closed.

The *Serrano* ruling combined with Proposition 13 to suppress school district revenue growth and virtually eliminate local control over most school funding. In the years since, California’s investment in education, relative to the national average, has declined. In 2005–06, the per-pupil expenditure was \$614 below the national average, and more recent funding cuts are likely to increase that gap dramatically. In addition, the fiscal stability of local school districts is damaged to the extent that their revenues are part of the state’s often dysfunctional budget process.



Policy changes could provide more local revenue control

Researchers, analysts, and local public officials have discussed several state policy changes that— if implemented by Sacramento decision-makers—would strengthen local communities’ ability to raise school revenues. A major examination of the options available was undertaken by the Finance and Facilities Working Group that was part of the Legislature’s Master Plan for Education effort, completed in 2002. More recently, a 2007 report from the Governor’s Committee on Education Excellence included an appendix devoted to the question.

Both documents argued that when taxpayers are directly assessed for their schools, they pay more attention to how well those schools are performing. Both also used the same basic parameters for evaluating the various local revenue options that might be possible. These included:

- the amount an option would yield,
- its stability as a revenue source,
- whether it was deductible for federal tax purposes, and
- the ease with which an option could be implemented.

Another consideration was whether the tax was progressive, meaning that those with a greater ability to pay are charged a higher amount. And finally, both reports addressed the potential inequities that could be caused by giving districts a more robust local revenue option. Districts would vary in their ability to adopt a local option and the same level of “tax effort” can result in different levels of additional revenues, particularly revenues per pupil. Both reports pointed to the need for the state to provide some additional funds in order to equalize yields among local communities.

The state could allow school districts to create a local income tax

Within the current parameters of state law, California lawmakers could allow school districts to ask local voters for an add-on to their income tax to support their schools. According to the Committee on Education Excellence report, five other states allow

this—Maryland, Iowa, Kentucky, Ohio, and Pennsylvania.

Income taxes in general have the benefit of being progressive. They would also be deductible from federal income taxes so that the federal government would effectively help subsidize the additional revenues. However, because income taxes fluctuate with the condition of the economy, they are not one of the more stable sources of revenue, particularly when an income tax system is largely dependent on high-income earners like California’s system is.

Although this option has been discussed occasionally, it has not gained substantial traction. It also raises several questions. What would various tax rates yield for schools? How would the yield-per-student vary among districts? What administrative issues might a local income tax raise?

Some policy options would require amending Proposition 13

Although Proposition 13 has long been thought of as politically sacrosanct, more discussions about revising it are occurring amid the state’s ongoing budget woes. Proposition 13 has had a number of unintended consequences that play a role in the state’s current revenue shortfalls. Those include a state tax base that relies on more volatile income taxes and a state-controlled and funded school finance system.

Three possible amendments to Proposition 13 have received the most attention. All of them would require voter approval. One

would make it easier for districts to pass parcel taxes and, perhaps, sales taxes. The other two would adjust current limits on the statewide ad valorem tax rate, either for all properties or just for commercial properties. For either of the latter two to make a difference for local school districts, the revenues raised would need to be outside of districts’ regular revenue limit allocations from the state.

Reduce the two-to-one approval threshold for parcel taxes and/or sales taxes

Requiring a two-thirds vote to approve parcel and sales taxes creates a high hurdle for districts to clear. Parcel tax history illustrates the point. Of the 486 parcel tax elections held between 1983 and June 30, 2009, 261 (54%) have passed. In the past two years—when schools have had to absorb substantial state funding cuts and delays—communities have passed 53 of 74 parcel tax measures, achieving a 72% passage rate. If a 55% supermajority option had been available for the past two years, the success rate would have been 96%. Had a simple majority been required, the approval rate would have been 99%.

The Legislature has periodically considered but failed to pass a constitutional amendment that would lower the parcel tax approval threshold to 55%, the same as facilities bond measures. If two-thirds of the Assembly and the Senate approves a current proposal, the state’s voters would then decide by majority vote whether to change the threshold.

However, if the measure were to pass in the Legislature and the public subsequently voted to lower the threshold, the hypothetical success rates discussed above would not necessarily carry over to the state as a whole. Additionally, flat-rate parcel taxes can result in relatively low revenues because the rate must be kept affordable for owners of the lowest-value parcels. The increased use of per-square-foot rates mitigates this to some degree. However, such rates are currently the subject of a legal challenge in the Alameda Unified School District. On the other hand, it is also possible that more districts would be willing to invest energy and resources into passing a parcel tax if the chances of success improved.

Allow local communities to assess property above the Proposition 13 limits

In its final report to the Legislature, the Master Plan Working Group recommended a constitutional amendment that would allow local school districts to propose to their voters a property tax override—above the Proposition 13 limit—for the exclusive use of public schools. The recommendation also called on the state to provide funding to ensure a minimum yield on each district's tax effort.

The Governor's Committee on Education Excellence made this option more concrete by exploring the revenue implications if districts were allowed to levy a 0.1% additional property tax, effectively bringing the tax rate to 1.1% of assessed valuation. Based on 2004–05 data, this tax would yield an average per-pupil revenue of \$706, according to the committee. Variations among districts would be dramatic, however. Among the 20 largest school districts, the per-pupil amounts would range from \$100 in Fontana Unified to \$1,950 in San Francisco. The report discusses at length the mechanisms the state could use to ensure a guaranteed tax yield and perhaps place a cap on the funds high-property-wealth districts could generate.

Reform how commercial property is taxed

Another aspect of Proposition 13 recently raised among proponents of reform is the handling of commercial and industrial property. Some reformers are advocating a change that would result in higher property tax rates for commercial-industrial property owners. The proposals tend to focus on three possible mechanisms to increase commercial-industrial property tax revenues:

- a “split roll,” which would maintain the current property tax limits for residential properties but reassess commercial-industrial property every year;
- a “split rate” so that commercial-industrial properties would be taxed at a rate higher than 1%; and
- a “split inflation rate,” meaning that the tax rate for commercial-industrial properties could grow more than 2% annually with no requirement to reassess each year.

Presumably, school districts might be allowed to use one of these mechanisms locally instead of them being implemented statewide. The benefit to school agencies would greatly depend on the concentration of commercial-industrial property in a district. Those in primarily residential areas would not benefit much from such a change. Important questions include which districts would benefit from this, what costs the state would incur if it provides some equalization funding, and what might be the negative effects on business. The political feasibility of changing Proposition 13 in a way that affects only business—rather than all property owners—is also an open question.



Local revenue options should be part of California's state budget reform debate

California's leaders are under increasing pressure to fix a budget process and finance system many see as dysfunctional. Several state groups are examining the feasibility of rewriting the state's constitution. And at the end of September, the governor is expecting tax reform recommendations from an advisory group called the Commission on the 21st Century Economy.

Ultimately, the state cannot fix its fiscal woes without addressing funding for public education. The amount of state money that goes to schools is too great to ignore. And if the state wants a qualified workforce to sustain California's economic viability, continuing to cut education funding is counter-productive. That is to say nothing

of long-standing hopes that California could increase its education investment.

The question of whether communities should have greater ability to raise revenues for their local schools, and under what conditions, ought to be considered as part of the larger financial discussion. That will require grappling with issues that are

complex and politically sensitive. One is the question of state versus local control of public schools and their revenues. Another is the differential ability of high-wealth communities to support their schools and what actions can and should be taken to equalize the revenue-raising ability of low-wealth communities.

The results of local bond and parcel tax elections provide good evidence that Californians want better and more stable funding for their local schools and would be willing to tax themselves if they believed the additional revenues would directly benefit their communities. Current law—in particular the provisions voters approved in Proposition 13—makes that largely impossible today.

It remains to be seen whether state law could be changed in a way that would return some meaningful revenue-raising power to local school districts, protect the equity interests of low-income communities, and garner the support of enough Californians to change the status quo. Current interest in a major overhaul of state finances provides a unique opportunity to at least have the discussion. 



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To Learn More

Links of interest

- For public opinion research related to school funding in California, consult the Public Policy Institute of California: www.ppic.org/content/pubs/survey/S_409MBS.pdf
- For a list of education foundations in California, see the California Consortium of Education Foundations website: www.cceflink.org
- For school district and state revenue data, go to the Ed-Data Partnership website, www.ed-data.org, and see financial reports.
- To learn more about efforts to initiate a Constitutional convention, see: www.repaircalifornia.org

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