SCHOOL FUNDING TASK FORCE

Wednesday, June 26, 2024
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Donald Schaible, Chairman, called the meeting to order at 10:00 a.m.

Members present: Senators Donald Schaible, Jay Elkin, David S. Rust; Representatives Pat D. Heinert, Jim Jonas, Anna S. Novak, David Richter, Mark Sanford, Cynthia Schreiber-Beck; Citizen Members Levi Bachmeier, Stephanie Hunter, Mike Lautenschlager, Maria Neset, Luke Schaefer, Adam Tescher

Members absent: Representative Eric James Murphy; Citizen Members Brandt Dick, Rick Diegel, Steve Holen

Others present: Mike Bitz, Mandan Public Schools; Jeff Fastnacht, Bismarck Public Schools; Mike Heilman, North Dakota Small Organized Schools; and Daren Kurle, Belfield Public School

It was moved by Representative Schreiber-Beck, seconded by Representative Novak, and carried on a voice vote that the minutes of the February 21, 2024, meeting be approved as distributed.

ELEMENTARY AND SECONDARY EDUCATION STATE AID AND FUNDING FORMULA STUDY

Mr. Adam Tescher, School Finance Officer, Department of Public Instruction, provided information (Appendix A) regarding school district excess ending general fund balances, school districts that continue to not be on the formula, consolidated school districts, limits on property tax increases, and the in lieu of property tax revenue deduction for the homestead and disabled veterans' property tax credits. He noted:

- Beginning July 1, 2027, pursuant to North Dakota Century Code Section 15.1-27-35.3, relating to the unobligated general fund balance of school districts, except for school districts that have entered into a cooperative agreement, the Superintendent of Public Instruction must reinstate the state school aid deduction for excess ending general fund balances. The deduction will be the unobligated general fund balance of the school district on the preceding June 30th which is in excess of 35 percent of the school district's actual expenditures, plus $50,000. School districts that have entered into a cooperative agreement will have a maximum of 2 years of the deduction being the unobligated general fund balance of the school district on the preceding June 30th which is in excess of 35 percent of the school district's actual expenditures, plus $100,000.
- From 2013 through 2021, the number of school districts subject to the excess ending general fund balance deduction ranged from 8 to 14 school districts. Except for the 2019-20 school year, the total deduction for all schools averaged just over $1 million. The late receipt of federal flood funds by one school district increased the total deduction to $4.6 million during the 2019-20 school year. Due to increases in funding from the federal Elementary and Secondary School Emergency Education Relief Fund in 2020 and 2021, deductions for excess ending general fund balances were suspended in 2021.
- School districts may transfer excess funding to a building fund to avoid the deduction; however, building fund uses are restricted and funds cannot be transferred back to the general fund.
- School district ending general fund balances have increased by approximately 35 percent since 2020. For the 2023-24 school year, if the general fund balance limitations were not suspended, 59 school districts would have exceeded their general fund limit. School districts may be carrying larger balances due to general fund savings from Elementary and Secondary School Emergency Education Relief funding and the absence of a penalty for the larger ending general fund balances.

- In lieu of property tax revenue is deducted in the state school aid formula in the year following the receipt of the revenue. When a school district's local revenue varies widely from year to year, a large increase in revenue in one year results in a lower state school aid payment the next year. In addition, if the school district maintains the extra funding in the general fund to cover the reduction in the next year, the additional funding in the general fund may result in an excess ending general fund balance deduction in the formula.
- The state began phasing out transition minimum adjustments, including per student and total dollar funding hold harmless calculations, during the 2021-22 school year. During the 2023-24 school year, 64 school districts received an additional $19.3 million of funding related to transition minimum adjustments, down from 102 school districts receiving $49.5 million during the 2019-20 school year. Phasing out transition minimum adjustments by a percentage per year has reduced additional transition minimum funding, but it will not reduce the number of eligible schools. Increases in the per student payment have raised some school districts to their minimum funding levels, reducing the number of school districts receiving transition minimum funding.
- Only 16 school districts in the state do not qualify for a school size weighting factor that allows school districts with fewer than 900 students to use a sliding scale to calculate a larger than actual student enrollment. When completely phased in, the sliding scale will use varying weighting factors to generate up to a 1.72 factor for school districts with fewer than 110 students. For school districts that merge, school size weighting factors are applied as if they continued as separate school districts for 4 years. Proportional adjustments are made in the 5th and 6th years, so beginning in the 7th year, the factor is applied as if they are one school district. For certain school districts with multiple plants at least 14 miles apart, the school size weighting factor is determined for each building separately, with no adjustment for elementary schools.
- Effective after June 30, 2025, or beginning with the 2025-26 school year, all school districts will be deducted 60 mills in the school funding formula and there will no longer be a 12 percent limitation on deduction increases. However, Section 57-15-14.2, which provides for property tax assessments, will continue to limit the increase in assessments to 12 percent each year, potentially limiting the amount school districts can assess to less than what will be deducted in the formula. Removing the 12 percent limitation on assessments would allow all school districts to assess up to 70 mills, of which 60 mills is deducted in the formula.
- The homestead and disabled veterans' property tax credits are deducted in the state school aid formula as local contributions from in lieu of property tax revenue. However, the property value collected by the Tax Department includes the taxable valuation of the property eligible for the homestead and disabled veterans' credits. To avoid duplication in the local contribution deducted in the state school aid formula, the Department of Public Instruction (DPI) must use a taxable valuation net of property eligible for the homestead and disabled veterans' credits. If the homestead and disabled veterans' credits were not deducted as in lieu of property tax revenue, DPI would be able to use the Tax Department's valuations to determine the 60 mill deduction in the formula without having to make adjustments for the property values related to the homestead and disabled veterans' credits. However, property values related to other property tax pilot programs that incentivize business may still require adjustments to a school district's total property valuation before determining the 60 mill deduction.

In response to a question from a task force member, Mr. Tescher noted large school districts typically are not impacted by the excess ending general fund balance deduction. He noted school districts with oil and gas tax and federal flood revenue are more prone to irregular revenue deposits and more often subject to the excess ending general fund balance deductions.

In response to a question from a task force member, Mr. Tescher noted recent increases in the per student payment rate have transitioned many school districts onto the formula without having to endure significant reductions in state school aid. However, a small number of school districts will see larger reductions when the transition minimum adjustments are completely phased out.

In response to a question from a task force member, Chairman Schaible suggested the task force receive information regarding the administration of the homestead and veterans' property tax credits and the mobile home tax.

Mr. Mike Heilman, Executive Director, North Dakota Small Organized Schools, provided information (Appendix B) regarding a transportation focus group proposal to integrate transportation funding into the state school aid formula. He noted:

- The goals of the focus group were to develop a funding method that could be integrated into the existing state school aid funding formula, reduce reporting requirements for schools, make the formula manageable for DPI, incorporate some of the factors included in a University of North Dakota study, and keep the cost funding neutral.

- For small schools, transportation expenditures are a large part of the budget, but the percentage of transportation expenditures reimbursed by the state has been declining.
- A stakeholder group used the University of North Dakota study to develop a proposal to integrate transportation funding into the state school aid formula and asked DPI to calculate various funding scenarios.

Mr. Tescher provided an analysis (Appendix C) of the transportation focus group proposal to integrate transportation funding into the state school aid formula. He noted:

- The analysis provides a summary by school district of transportation expenditures for the 2022-23 school year and reimbursements for the 2023-24 school year. Transportation reimbursements are based on prior school year miles and rides. Statewide, under the current block grant formula, school districts are reimbursed for approximately 31.2 percent of expenditures, but reimbursement percentages vary greatly by school district.
- The analysis converts factors, including large and small bus miles and runs, land area, number of schools, and family transportation, to weighted student units, which are applied to the per student payment rate to determine the reimbursement. Because transportation funding is included in state school aid, there would no longer be a separate appropriation for transportation grants, and the state school aid appropriation would be increased. When percentage increases are approved for the per student payment rate, transportation reimbursements based on the per student rate would be increased by the same percentage.
- In the analysis, transportation and weighting factors were adjusted to generate a total reimbursement that would align with the $58.1 million appropriated for transportation grants during the 2023-25 biennium. In the proposal, school districts do not incur a decrease in funding but some school districts reach the reimbursement limit of 90 percent of expenditures.
- Reimbursements under the current formula have been approximately $25 million per year and DPI estimates unspent funding related to transportation grants. The fiscal impact of the proposal to integrate transportation funding into the state school aid formula, as presented in the analysis, is an increase of approximately $3 million per biennium compared to the 2023-25 biennium appropriation for transportation grants, or an increase of approximately $10 million per biennium compared to estimated reimbursements for the 2023-25 biennium. If the per student payment rate is increased in 2025, the fiscal impact would be higher.
- If the funding model is adopted, reimbursable school bus runs would need to be more clearly defined.

In response to questions from a task force member, Mr. Tescher noted:

- A factor related to miles of gravel road was discussed, but the focus group determined distinguishing types of roads added reporting risk.
- Because they are not reimbursable, the analysis did not include open-enrolled students.
- The number of runs may be impacted if both resident and open-enrolled students are transported on the same run.

At the request of Chairman Schaible, Mr. Tescher provided a second copy of the analysis of the proposal to integrate transportation funding into the state school aid formula, which included school district reimbursements under the new formula as a percentage of expenditures (Appendix D).

In response to a question from a task force member, Mr. Bachmeier noted state procurement does not offer contracts for school buses.

Dr. Jeff Fastnacht, Superintendent, Bismarck Public Schools, provided information, as the co-chair of the transportation focus group, regarding the transportation funding proposal. He noted while the transportation formula does not include a factor for gravel roads, there is a factor for school district size.

Mr. Daren Kurle, Superintendent, Belfield Public School, provided information (Appendix E) regarding school construction coalition considerations. He noted:

- There are no state standards for school buildings, but some school districts have used the Minnesota model regarding square footage per student.

- Facility assessments are important to identify deferred maintenance costs across the state, but standards for conducting and reviewing assessments have not been established.
- Passing a bond referendum in North Dakota requires 60 percent voter approval. However, Montana only requires a simple majority if voter turnout is more than 40 percent, but if voter turnout is less than 30 percent, the referendum automatically fails.
- Additional funding for school construction has not been identified. However, even as small school district bond referendums and building fund approvals have failed recently, the coalition believes school districts should bear some financial responsibility.

Representative Richter provided information regarding an exemption for in lieu of property tax revenue in the state school aid formula and a provision to allow school districts to use the funding for school construction, including funding scenarios (Appendix F), local contributions (Appendix G), and information related to selected schools (Appendix H). He noted:

- School districts are currently able to reduce all in lieu of property tax revenue types by the percentage of mills levied by the school district for sinking and interest relative to the total mills levied before deducting 75 percent of the revenue in the state school aid formula.
- As an alternative, school districts could choose to exempt a percentage of the in lieu of property tax revenue, based on the percentage total in lieu of property tax revenue represents of the total local contribution, from deduction in the state school aid formula and use the funding for school construction.
- The funding scenarios document offers a comparison of the formula deduction for in lieu of property tax revenue, using both the current exemption for a percentage of the sinking and interest mill levy and the proposed exemption based on the percentage of in lieu of property tax revenue to the total local contribution. School districts could compare the deduction and total state aid under the current percent of sinking and interest levy exemption (the third set of columns) and the deduction under the proposed option to use the percent of in lieu of property tax revenue exemption (the first set of columns) and elect the method that provides the lower local revenue deduction.
- The in lieu of property tax revenue exemption would be limited to a bond payment and the exemption would not go beyond the life of the bond.
- The proposal to exempt additional in lieu of property tax revenue from deduction in the state school aid formula would cost the state approximately $8 million per year or $16 million per biennium.

In response to questions from task force members, Mr. Tescher noted:

- There are no restrictions on the use of revenue currently exempted from deduction in the formula based on sinking and interest mill levies.
- Large variances in local revenue from one year to the next will make managing the exemption election a challenge for DPI and the school districts.
- School districts that do not levy for sinking and interest and do not have a bond payment are included in the analysis. If those school districts are not eligible for the in lieu of property tax revenue exemption, the fiscal impact of the change would be lower than the amount presented.
- There is no restriction on the use of the 25 percent of local in lieu of property tax revenue retained by school districts.

Dr. Mike Bitz, Superintendent, Mandan Public Schools, noted the deduction for 75 percent of local in lieu of property tax revenue in the state school aid formula provides equity in the formula by ensuring similar funding per student across the state.

Task force members noted:

- Eliminating the excess ending fund balance deduction in the state school aid formula would protect school districts from the clawback of certain unpredictable in lieu of property tax revenue payments and allow school districts to save money for unexpected large expenses.
- A sliding scale for school construction loan assistance would benefit the school districts most in need.

Task force members noted the task force, at a future meeting, could review:

- Ways to simplify bond initiative language and statutory changes to the definition of the school district debt limit.

- How consolidation may lead to construction incentives.
- How school districts qualify for the various school construction assistance revolving loan fund tiers and the possibility of increasing deposits to the school construction assistance revolving loan fund.
- The ability of state procurement to bid school buses and statutory changes needed to allow for group purchasing of buses.
- Increasing the threshold for DPI approval for school projects.
- Potential costs relating to addressing teacher shortages and school choice initiatives.

No further business appearing, Chairman Schaible adjourned the meeting at 2:59 p.m.

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Sheila M. Sandness
Senior Fiscal Analyst

ATTACH:8