

Revenue Options

The Committee recognizes that implementing the proposed reforms will require resources beyond those it anticipates will be generated by the natural growth in Proposition 98 funding that will occur through the Test 1 formulas in the near future. To offset this demand, the Committee examined and discussed at length various options for both state and local revenue enhancements. Despite focused consideration, the Committee did not achieve consensus on a package of appropriate local revenue options to recommend, and members did not believe their particular areas of expertise positioned them to best determine a preferred source of state-level revenue.

Although the Committee was unable to come to consensus in favor of specific revenue options, it is important to recognize that significant benefits attend local revenue generation — as do certain difficulties. This appendix examines many of the positive and negative consequences the Committee considered in relation to various local revenue options.

Why Allow Local Revenue Generation?

Despite the significant investments local taxpayers make in support of their schools, under the current education finance structure, the revenues available to districts are primarily determined by the state and, to a lesser extent, the federal government. The nature of this funding relationship is discussed more fully in the Finance chapter of this report. It is possible to alter this relationship, and thereby give local districts more control of the level of resources available to them, by raising and distributing local revenues more strategically. Adding a local revenue option to the education finance system could provide multiple benefits, either under the current system or the transformed system recommended by the Committee. Specifically:

- **Provide additional revenues to districts.** Obviously the primary reason to allow an option for local revenue generation is to provide school districts with additional revenues. These additional revenues could mitigate some of the deficiencies noted throughout this report, such as the lower levels of staffing California’s schools have in comparison to other states; higher class sizes; and fewer specific instructional resources, education programs, or support services. In addition to these current considerations, many of the Committee’s recommendations for additional investments would provide increased funding, primarily to districts with greater proportions of disadvantaged students. Providing a local revenue-generating option would allow districts with fewer disadvantaged students to bring additional resources into their schools, even as it would allow schools with concentrations of disadvantaged students more flexible revenues. Moreover, authorizing districts and communities to generate revenue could be linked, in whole or in part, to the implementation of specific reforms, which might include critical foundations such as improved local data information systems, enhanced provision of preschool services, or more rapid transition to a professional practice model.
- **Empower local boards to re-engage the electorate.** Currently, local school boards have little to no control over the size of their operation budgets. While local property taxes are one of the chief funding sources for school districts, school district budgets generally are not impacted by the level of local revenues the property tax generates, and the local board

cannot change the tax rate citizens pay.¹ Because the board cannot raise taxes, many voters pay little attention to school board elections or to a district's efficiency. Restoring taxation authority to local districts would begin to reinvigorate public engagement in school district governance. In general, governments are more efficient with funding that comes from local constituents than funding that comes from another level of government, so districts might use local funds more effectively than state-generated funds. Such local re-engagement also can create more community buy-in to reforms the district considers. For example, Denver voters' approval of a local tax to support the city's professional compensation system for educators signaled community support of the reform itself — increasing the likelihood that the reform will be sustained over time. The link of taxation to specific reforms in this way can have the additional benefit of enhancing local accountability, since voters will be able to observe whether program or achievement outcomes mirror what they agreed to pay for and will be able to act on their findings.

- **Reduce tensions between school administration and unions.** Currently, school district budgets operate within a zero-sum principle. For example, providing additional compensation for educators by necessity precludes enhancing educational programs or other supports, which could lead to larger class sizes or reduced program offerings. When local revenue options are available, districts seeking voter support must work collaboratively to continually prove to voters that investing in their schools is worthwhile. Local constituents can weigh the tradeoffs of various investments. Thus, a local revenue source can help reduce labor-management tensions.

Which Tax Should the State Consider for a Local Revenue Option?

Determining whether to pursue enhanced local revenue generation cannot be done in a vacuum or in the abstract. A number of different options exist, each with its own benefits and detriments, and those attributes influence the desirability of revenue generation. Stanford University researcher Susanna Loeb has highlighted three key criteria for evaluating the desirability of different local revenue options: level of progressivity, stability, and ease of implementation.² The Committee also believes two other characteristics are highly important in evaluating revenue options: federal deductibility, which offsets the personal impacts of these taxes, and associated adverse incentives. If policymakers are considering a new local revenue source for schools, they should consider each of these properties in the decision-making process:

- Progressivity is desirable because the tax relies more heavily on those taxpayers that have the greatest ability to pay and less on taxpayers with less ability to pay.
- Stability ensures that school districts are able to conduct multiyear planning and make longer-term commitments, which can increase efficiency and decrease the possibility of districts' facing fiscal crises.
- The easier the implementation, the less cost involved in it. Since the cost of collection, auditing, enforcement, and other administrative expenses provide cost without direct benefit, policymakers want to minimize the implementation costs.
- If taxpayers can deduct a portion of their local tax on their federal taxes, the net result is as if the federal government is paying a portion of their tax. From the state and local perspective, as well as from taxpayers' personal perspectives, maximizing the benefits of federal deductibility is desirable.
- Adverse incentives are economic impacts that can result from various taxes that policymakers implement; these should be considered prior to adopting a local tax.

The chart "Properties of Various Local Revenue Options" summarizes the evaluation of several potential sources of local revenue in relation to those five criteria. Following the chart are summaries of the properties of each local revenue option.

Properties of Various Local Revenue Options

Tax	Progressivity	Stability	Ease of implementation	Federally deductible	Incentives
Local income tax	Progressive	Less stable	Minimal additional costs	Yes	Can create location-based gaming if tax is high
Local sales tax	Regressive/moderate with exemption	Less stable	Low at county level	No	Can adversely impact business location decisions, especially if at district level
Parcel tax	Regressive	Stable	Low	No	Minimal
Property tax	Progressive	Stable	No additional costs	Yes	New residents bear higher burdens

Source: Governor's Committee on Education Excellence

Local income tax

This tax is considerably volatile, especially in California where a highly progressive income tax is dependent on the income of a small group of high-income earners. According to the Legislative Analyst's Office (LAO), California's income tax is so volatile because of the combination of a progressive tax structure, an accumulation of wealth among a small number of very high-income earners, and the fact that the income of those high earners depends on volatile income sources such as bonuses, stock options, capital gains, and business profits.³ If policymakers considered a local income tax, districts would be exposed to increased volatility because a decrease in income taxes would affect them through two sources: their direct local tax and the state budget. One advantage of this tax is that it is deductible from federal income.

Four states allow a local income tax surcharge at the district level, and one allows a county surcharge that goes to districts. Maryland levies county (and city of Baltimore) income taxes that generate approximately 18 percent of its school revenues. Pennsylvania has the most significant district-level income tax, which raises more than \$.5 billion annually at the district level (4 percent of revenues). Other states generate less than 1 percent of their revenues from the local income tax, including Iowa, Ohio, and Kentucky. Farmers tend to prefer the income tax to a property tax in these states, since their income comprises a smaller share of statewide income than their share of the property tax base. In Pennsylvania, for example, the cost of state collection and distribution of the revenues from the local income tax was approximately 1.5 percent of revenue generated by the tax.

Local sales tax

This tax is generally perceived to be regressive, but the regressivity is reduced somewhat in California by the broad tax exemptions provided for food and drugs. Local sales taxes distort shopping behaviors in communities near a jurisdictional border, since businesses will locate in counties/districts with lower tax rates and since consumers also will shop at stores with the lower taxes. Local sales taxes also have been criticized for their impact on local zoning and land use decisions, and the higher the sales tax, the stronger the incentive to skew these decisions. Increasing this tax, therefore, could exacerbate this problem. Sales tax revenues are rather volatile. This volatility could be reduced, however, if more services were included in the tax base. An additional disadvantage is that this tax is not deductible from federal income taxes. An additional local sales tax could be collected in California at the county level with little administrative difficulty, basically connected to other efforts; collecting this tax at the district level, however, could add administrative complexity, with resulting higher administrative costs. Louisiana is the only state that allows districts to levy a local sales tax, while other states allow it

primarily through counties. Louisiana generates 19 percent of its schools' revenue from this source, while counties in Tennessee and Alabama generate approximately 7 percent of revenues from sales taxes. Alaska (4 percent) and Virginia (3 percent) are the only other states to raise much revenue from this source.

Parcel tax

As traditionally implemented — strictly on the basis of a per-parcel levy — parcel taxes are the most regressive of the taxes available for local implementation. The extent of the regressivity depends on the ability of landlords to pass along the burden of this tax to renters. That ability generally varies by community, depending on conditions in the local housing market. Parcel taxes also are not deductible in federal tax calculations, so the federal government does not subsidize this tax as it does property tax. Berkeley Unified has passed a parcel tax that mitigates the regressivity by basing the calculation of the parcel tax on *both* the square footage of the house and the number of its rooms. California's courts have not yet ruled on whether the usage of such factors constitute a *de facto* tax on the value of the house, which is capped by Proposition 13.

While parcel taxes provide a relatively stable income source, in California, they are generally used in homogeneous middle- and high-income communities. Currently the parcel tax generates about 2 percent of school revenues in California, but these revenues are concentrated in a small handful of districts. Other states do not rely on the parcel tax.

Property tax

The property tax is progressive and generally is relatively stable — although the current housing crisis has made it slightly less stable for the near future. The graphic “California’s Property Tax Has Been More Stable Than General Fund Tax Revenues” demonstrates the relative stability of the property tax in comparison to the multi-sourced General Fund revenues. The property tax is deductible from federal tax payments so that, in effect, the federal government pays for a portion of the revenues generated by it. Since the property tax already is being distributed to school districts, expanding this option would create almost no additional administrative costs. The chief disadvantage of the local property tax is the inequity of the tax between new homeowners and long-time residents. Researchers have shown that in some communities, a new neighbor’s tax rate can be 10 times higher than a long-time resident’s.⁴



Based strictly on assessment against the five criteria used by the Committee, the property tax emerges as the most desirable source for local revenue generation, if the state were to consider adopting such a policy. As such, it is not surprising that local property taxes already are a principal revenue source of school districts nationwide, providing 43 percent of total K–12 revenues in 2003–04.⁵ However, pursuit of this option for additional local revenue generation in California has obviously significant political implications, because it would require amending portions of the Constitution established by Proposition 13.

Addressing Potential Inequities Caused by Local Revenue Generation

Since the property tax was identified as the preferred local option, this section explores revenue inequities primarily in the context of that specific tax.

Any local revenue source will have unequal tax bases because property wealth, income, or local sales volumes will differ by jurisdiction. Inherent in the concept of creating a local revenue option is the presumption that communities have a choice about the level of education funding that their local schools receive. With this choice comes the likely outcome that some communities will be able to access the additional revenue source more easily than others. Because of this, California should consider a local revenue option only to support enrichment funding on top of an already “adequate” funding system. If the base funding system is adequate, the local revenue option allows communities to choose to provide their students with a higher level of enrichment activities, rather than local communities compensating for low state support of education. Even if a local revenue option is provided in addition to an adequate base, the state has a role to play to ensure that different communities have relatively equal access to additional funding. To determine how the state can improve the equity of access to local revenues, we must first look at the sources of inequity. A local revenue option could result in inequities for two inter-related reasons:

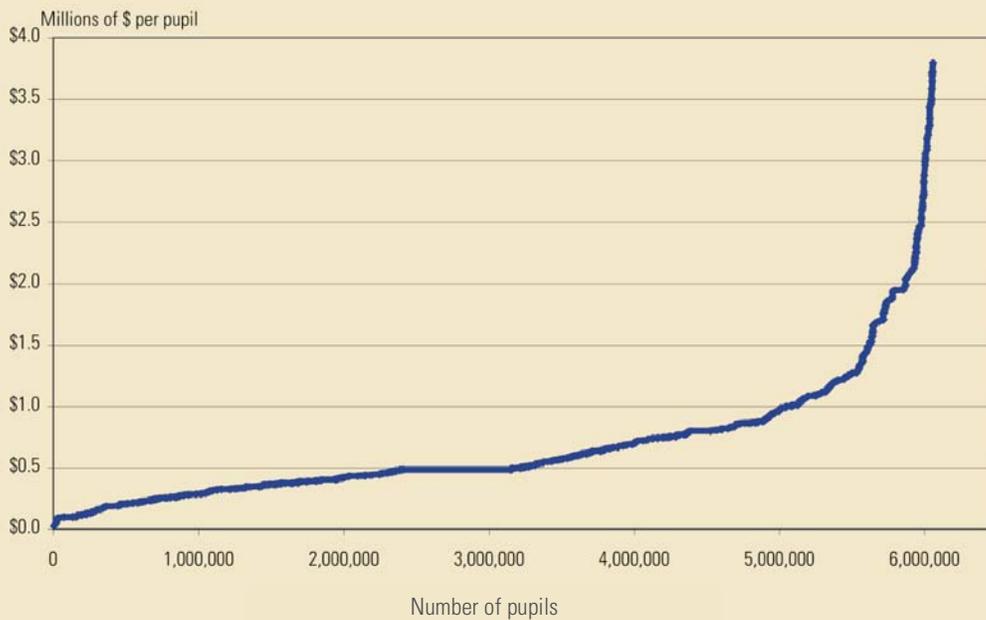
Districts will vary in their ability to adopt a local option

There are at least three reasons one district might be more likely to increase its local property taxes than another district. First, voters in some districts may be more affluent and willing to make additional investments in their schools. Second, certain areas of the state have a higher propensity to support local taxation because of such factors as political affiliation. Third, districts perceived as being more efficient with their use of public funds are more likely to generate additional revenues.

The same level of effort will result in different levels of additional revenues

Because there is wide variation in the assessed property value per pupil across districts, absent any adjustments, some districts would be able to generate more revenues with a similar level of effort. (There follows below a discussion of the legal constraints that likely require an adjustment to be made.) Using data collected as part of the Getting Down to Facts research project, the graphic “Distribution of the Assessed Property Value per Pupil” shows the variation in assessed property value per pupil by school district.⁶ It demonstrates that a district at the 10th percentile has about \$218,000 in assessed property value per pupil, while a district at the 90th percentile has some \$1.2 million per pupil. These data show that there are large inequities, especially at either end of the distribution. In fact, the graphic excludes the 34 districts with the highest per capita assessed value — in excess of \$4 million per pupil.

Distribution of the Assessed Property Value per Pupil (In Rank Order)



Source: Governor's Committee on Education Excellence using Brunner (2007) data

The chart "Assessed Value per Pupil of California's Largest 20 Districts" illustrates the range of local property wealth across the state: San Bernardino City Unified is in the lowest 2 percent of districts when ranked by their assessed value per pupil, while San Francisco Unified is at the 96th percentile of the distribution of districts ranked by assessed value per pupil. In the past, many believed that these inequities were linked to the income of a community, with lower-income communities having low assessed value per pupil and wealthier communities having high assessed value per pupil. While there is a relationship between the wealth of a community and the assessed value per pupil, the relationship is not as strong as commonly expected. For one, many low-income communities have significant commercial property within their tax-district boundaries, which raises the assessed value per pupil, since fewer children reside there. The graphic "Property Values Vary by Community Income" more directly demonstrates the relationship between assessed value and concentrations of low-income students.⁷ At the ends of the distribution, common perception seems to hold: Very wealthy communities have higher assessed value per pupil, and impoverished communities have low assessed value. In the midrange, however, the relationship is not as strong as some would have thought.

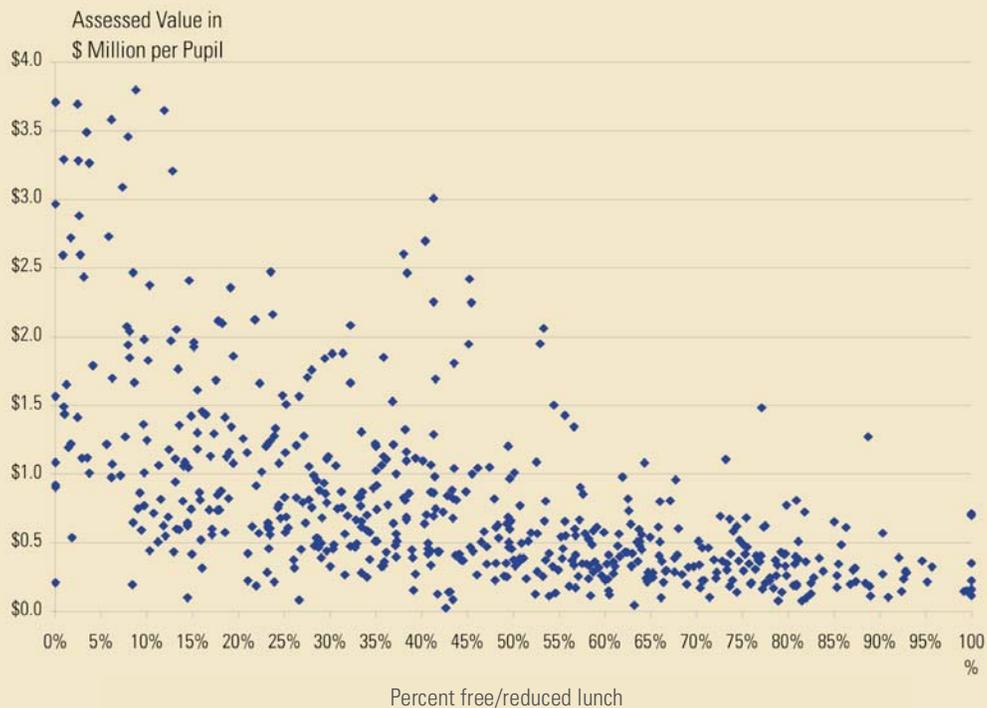
Assessed Value per Pupil of California's Largest 20 Districts

District	2004–05 enrollment	Assessed value per pupil	District's Ranking of Assessed Value (Percentile in the State)	Revenues per pupil from a 0.1% additional property tax
Los Angeles Unified	741,367	\$486,619	52%	\$487
San Diego Unified	134,709	\$802,649	74%	\$803
Long Beach Unified	96,319	\$405,959	32%	\$406
Fresno Unified	80,760	\$190,754	7%	\$191
Santa Ana Unified	61,693	\$349,827	23%	\$350
San Bernardino City Unified	59,105	\$100,849	2%	\$101
Elk Grove Unified	58,670	\$392,052	30%	\$392
San Francisco Unified	57,144	\$1,949,569	96%	\$1,950
Sacramento City Unified	51,420	\$433,923	34%	\$434
Capistrano Unified	50,615	\$1,087,470	86%	\$1,087
San Juan Unified	50,089	\$499,071	53%	\$499
Garden Grove Unified	50,030	\$328,817	20%	\$329
Oakland Unified	49,214	\$637,555	62%	\$638
Corona-Norco Unified	45,551	\$448,387	37%	\$448
Riverside Unified	42,521	\$375,998	27%	\$376
Fontana Unified	42,050	\$99,512	1%	\$100
Sweetwater Union High	40,888	\$724,485	67%	\$724
Stockton City Unified	39,268	N/A ¹		
Mt. Diablo Unified	36,271	\$756,802	70%	\$757
Montebello Unified	36,000	\$285,270	16%	\$285

1. San Joaquin county assessor was unwilling to share the information with the researcher, so data for Stockton Unified is missing.
Source: Governor's Committee on Education Excellence, using Brunner (2007) data

Adjustments can be made to any local revenue option to at least partially address these potential inequities. Even with such adjustments, however, some districts may choose not to adopt a tax increase while other districts do, and this will cause some differentiation in the level of funding available to districts. Some believe that taxpayers are more likely to support local revenues in school districts that the taxpayers perceive to be efficient and high-functioning. Thus, if a school district is perceived to be dysfunctional, low-performing, or inefficient, the taxpayers may be less willing to pass a tax that provides this type of district more funding. Since the districts perceived as low-functioning are usually low-performing and are not likely to pass a local tax, and districts that are high-functioning are more likely to pass a local tax, there is a possibility that a local revenue option may impact the overall achievement gap. For this reason, the Committee would not consider a local revenue option unless it were (1) provided on top of a base that the Committee believed was "adequately" funded and (2) distributed to districts in a way that recognized differential needs of students so that districts with more English learners, economically disadvantaged students, or special education students received higher funding.

Property Values Vary By Community Income



Source: Governor's Committee on Education Excellence, using Brunner (2007) data

Meeting legally required wealth neutrality

If the state begins to allow districts to have discretion in determining their local property tax rates (or other taxes), the state also must address any inequities in the tax base to avoid legal issues. As part of the rulings in the *Serrano v. Priest* lawsuits, the California Supreme Court generally concluded that the ability of a community to raise revenues for schools could no longer be linked to the property wealth of the school district. To meet this requirement, the state would need to make adjustments to ensure that the level of revenues generated by a similar level of effort would be equal across districts. The state could ensure that any changes to the tax laws did not violate equity through a guaranteed tax yield, either by itself or in combination with a cap on high-wealth districts:

1. **Provide a guaranteed tax yield.** The inequity in tax revenues that might result from local differentiation in tax rates or bases can be overcome through a "guaranteed tax yield program," whereby the state would guarantee specific additional revenues per pupil based on any specific local effort (i.e., the percentage of increase in the tax rate that the local district is willing to enact). To implement this, the state would set a maximum increase in the tax rate and determine the minimum per-pupil yield each district should be able to generate. If a district's actual local revenue yield proved insufficient to reach the average, the state would provide additional state revenues to make up the difference. Using the example of a 10 percent increase (i.e., raising the rate from the current 1 percent to 1.1 percent) and a minimum yield of the level of additional revenue per pupil as generated by the average district in the state, each district would be guaranteed that for increasing local taxes by 10 percent, it would receive at least \$706 per pupil. For additional illustration, the chart "Assessed Value, and Guaranteed Yield Options" demonstrates how a guaranteed yield would work for the 20 largest districts, using guaranteed yields of the statewide average, the 75th percentile, or the 90th percentile district in the state. The chart shows the percentage of funding that each of these districts would

generate locally and the matching funds that the state would provide. These percentages could be applied to any level of local increase, although we only provide the revenues generated from a 10 percent and a 20 percent increase in the local property tax rate. For example, Los Angeles Unified has an assessed value of \$487,000 per pupil, or 69 percent of the statewide average of \$706 per pupil. If the guaranteed tax yield from that assessed value was the statewide average with a maximum 10 percent increase in the tax rate, then Los Angeles Unified could generate \$487 per pupil (69 percent of the statewide average), and the state would contribute \$219 per pupil to meet the statewide target of \$706 per pupil. So for Los Angeles Unified, for each dollar the community contributed, the state would provide a match of \$0.45. If the target for the guaranteed yield was the 90th percentile, then Los Angeles Unified would still generate \$487 per pupil, and the state would provide \$759 per pupil (\$1.56 match for each local dollar).

Assessed Value, and Guaranteed Yield Options

(Twenty largest districts in the state)

Potential Targets	10% Tax	20% Tax	Percentile										
	Increase	Increase											
90th Percentile	\$ 1,246	\$ 2,492	90%										
75th percentile	\$ 806	\$ 1,613	75%										
State Mean	\$ 706	\$ 1,412	66%										
State Median \$/student	\$ 487	\$ 973	50%										

District	Assessed Value per pupil (in \$ thousands)	Percentile Rank of Assessed Value per Pupil	Pct. receiving free or reduced price lunch	State Average (66th Percentile)			Guaranteed Yield at 75th Percentile			Guaranteed Yield at 90th Percentile		
				Local potential %	State match	% surr if cap	Local potential as % of guaranteed yield	State match compared to local contribution	% of local funds surrendered if g'teed yield is a cap	Local potential %	State match	% surr if cap
				Los Angeles	\$ 487	52%	75%	69%	0.45x		60%	0.66x
San Diego	803	74%	54%	114%	-12%		100%		0%	64%	0.55x	
Long Beach	406	32%	66%	58%	0.74x		50%	0.99x		33%	2.07x	
Fresno	191	7%	81%	27%	2.70x		24%	3.23x		15%	5.53x	
Santa Ana	350	23%	73%	50%	1.02x		43%	1.31x		28%	2.56x	
San Bernardino	101	2%	82%	14%	6.00x		13%	7.00x		8%	11.35x	
Elk Grove	392	30%	39%	56%	0.80x		49%	1.06x		31%	2.18x	
San Francisco	1,950	96%	53%	276%	-64%		242%	-59%		156%	-36%	
Sacramento	434	34%	62%	61%	0.63x		54%	0.86x		35%	1.87x	
Capistrano	1,087	86%	14%	154%	-35%		135%	-26%		87%	0.15x	
San Juan	499	53%	29%	71%	0.41x		62%	0.62x		40%	1.50x	
Garden Grove	329	20%	61%	47%	1.15x		41%	1.45x		26%	2.79x	
Oakland	638	62%	63%	90%	0.11x		79%	0.26x		51%	0.95x	
Corona-Norco	448	37%	39%	64%	0.57x		56%	0.80x		36%	1.78x	
Riverside	376	27%	50%	53%	0.88x		47%	1.14x		30%	2.31x	
Fontana	100	1%	66%	14%	6.09x		12%	7.10x		8%	11.52x	
Sweetwater Union High	724	67%	42%	103%	-3%		90%	0.11x		58%	0.72x	
Mt. Diablo	757	70%	28%	107%	-7%		94%	0.07x		61%	0.65x	
Montebello	285	16%	72%	40%	1.47x		35%	1.83x		23%	3.37x	

1. San Joaquin county assessor was unwilling to share the information with the researcher, so data for Stockton Unified is missing.

Source: Governor's Committee on Education Excellence

Extracting data from this chart, still using a 10 percent increase and a state guarantee of the average district's yield, allows closer examination of the impact of a guaranteed tax yield program in both low-wealth and high-wealth districts:

- **Low-wealth district — Fresno Unified.** If a low-property-wealth district such as Fresno Unified passed a 10 percent increase in its property taxes, it would receive an additional \$191 per pupil from local taxes, and the state would provide \$515 per pupil in matching funds to meet the statewide target of \$706. If the target was the 90th percentile (\$1,246 per pupil), the local share would remain \$191 per pupil, and the state would provide \$1,055 per pupil.
- **High-wealth district — San Francisco Unified.** For a high-property-wealth district such as San Francisco Unified, the state would provide no subsidy under either scenario. In fact, the 10 percent level of effort would provide San Francisco Unified with an additional \$1,950 per pupil, almost triple the statewide average and more than 1.5 times the 90th percentile target. The state may need to constrain the additional revenues that could be generated by a district with wealth such as that of San Francisco. (See discussion below.)

2. **Cap the high-property-wealth districts.** The state cannot afford to set the guaranteed yield at a rate that would fully equalize districts' property tax bases because some districts have extremely high assessed value per pupil. Most of these districts are in wealthy regions of the state — Marin County, the Peninsula, or southern California beach communities. Many of these high-end outliers are "basic aid" or "excess tax" districts — the entirety of their revenue limits (general purpose funds) are provided by local tax revenues — that already receive extra funding generated locally. Other districts have few students and various anomalies, such as oil production within the district's boundaries. These districts could generate significant additional per-pupil funding with small increases in the property tax rate. For example, a 10 percent property tax increase by Sequoia Union High School would generate almost \$5,700 per pupil, nearly 12 times more than the median district — Los Angeles Unified — would generate with the same effort. The state could not afford to subsidize Los Angeles Unified up to the revenue level of Sequoia. The state could employ two mechanisms to address these potential inequities: cap the additional revenue that a high-wealth district could generate; or allow high-wealth districts to increase taxes up to the maximum allowable rate but require them to contribute a portion of the new revenues to the state's General Fund, to offset state costs of guaranteeing yields to lower-wealth districts.

The chart "Maximum Cost To Provide Guaranteed Yield to Property Poor Districts" shows four potential guaranteed yield target levels — state median, state mean, 75th percentile district, and 90th percentile district. The chart shows the maximum cost to the state of each option, and the potential local revenues that could be generated. In all scenarios, the data assume that the highest-property-wealth districts are constrained because without limits some of these districts could generate more than an additional \$10,000 per pupil with the same level of effort — creating untenable levels of inequity. If the state set a target at the statewide average, the maximum cost to the state if every district below the average took advantage of the subsidy would be \$1.2 billion. This level of state effort also would generate \$4 billion in additional local revenue for a total of \$5.2 billion in additional revenues.

Maximum Cost to Provide Guaranteed Yield to Property Poor Districts

Allowing an additional local property tax of 0.2%
(Without recapture from the "rich")

Guaranteed Yield Level	Additional funding per pupil	Maximum Additional Funding (State + Local)	State Subsidy rate	Maximum State Costs
Statewide Median	\$ 972	\$8.8 billion	37%	\$0.8 billion
Statewide Average (66th pctile)	\$ 1,412	\$10.4 billion	43%	\$2.4 billion
75th Percentile	\$ 1,612	\$11.2 billion	45%	\$3.2 billion
90th Percentile	\$ 2,490	\$15.8 billion	57%	\$7.8 billion

Allowing an additional local property tax of 0.1%
(Without recapture from the "rich")

Guaranteed Yield Amount	Additional funding per pupil	Maximum Additional Funding (State + Local)	State Subsidy rate	Maximum State Costs
Statewide Median	\$ 486	\$4.4 billion	37%	\$0.4 billion
Statewide Average (66th pctile)	\$ 706	\$5.2 billion	43%	\$1.2 billion
75th Percentile	\$ 806	\$5.6 billion	45%	\$1.6 billion
90th Percentile	\$ 1,245	\$7.9 billion	57%	\$3.9 billion

Source: Governor's Committee on Education Excellence

Increasing revenues while mitigating property tax inequities

All of the property tax adjustments described above would require adjustments to the current implementation of Proposition 13 — either through statutory changes or even constitutional amendment. At the same time as it accommodated property tax increases, the state could begin to mitigate the inequities of local property taxes between high-paying new residents and low-paying long-time residents. The Committee examined several options for addressing these issues, with a strong recognition of Californians' interest in the spirit of Proposition 13. Most promising among these options was a three-step process for increasing revenues within a 1 percent cap on taxation, while creating a fairer distribution of tax burden among Californians.

1. First, the state would take an action to move toward assessing property values based on market value. This likely would take place over a multiyear period and could include changes to practices for both residential and commercial property. Various protections — such as increasing the property tax exemption from \$7,000 to a realistic, contemporary level — could insulate the most vulnerable taxpayers, such as retirees, farmers, or renters, who end up paying higher taxes assessed on apartment owners.
2. Because reassessments would increase total statewide assessed value, the state could reduce the statewide property tax rate from the 1 percent to a lower rate that would maintain the same level of aggregate property tax revenues (for illustrative purposes, the property tax rate might be reduced from 1 percent to 0.8 percent). Here, the state might need to make adjustments to hold local governments harmless.
3. With statewide property taxes reduced, local districts could be empowered to increase their own property tax rates, up to a combined state/local cap of the existing level of 1 percent.

Notwithstanding the complexity of this approach, it would make available additional revenues to school districts, eliminate several economic inefficiencies caused by the current property valuation policy, and still maintain the highly valued 1 percent cap on property taxes.

Endnotes

¹ This lack of connections occurs because the state's revenue limit funding directly offsets any increase in local property tax revenues with a reduction in state General Fund support. Thus, if a district's revenue limit is \$5,000 per pupil, and the district's local property taxes increase from \$2,000 per pupil to \$2,500 per pupil, the state General Fund revenues decrease from \$3,000 per pupil to \$2,500 per pupil. Basic aid or excess tax school districts are an exception here. For these districts, their entire revenue limit is generally funded by the local property tax, and the local district is able to keep any additional local revenue beyond the revenue limit. In these cases, a local board could theoretically reduce their local property taxes, but no district has ever done this. There is a perception that basic aid districts have a greater connection to their community, and part of that explanation could be the reduced dependence on the state budget process to determine their fiscal fates.

² Loeb, Susanna (2001) "Local Revenue Options for K–12 Education," *School Finance and California's Master Plan for Education*, Public Policy Institute of California, San Francisco.

³ Legislative Analyst's Office (2005) *Revenue Volatility in California*.

⁴ Steven Sheffrin and Terri Sexton (1998) *Proposition 13 in Recession and Recovery*, Public Policy Institute of California, San Francisco.

⁵ National Center for Education Statistics (2006) *Digest of Education Statistics*, Washington, DC.

⁶ The assessed value data analyzed by Committee staff was collected from county assessors and generously provided by Eric Brunner (2007) *Financing School Facilities in California*, Getting Down to Facts, Institute for Research on Education Policy and Practice, Stanford University. A small number of counties did not participate in this survey. Additionally, a set of 34 small districts with assessed value in excess of \$4 million per pupil have been excluded.

⁷ This data comes from Brunner (2007) and also excludes a set of 34 small districts with assessed value in excess of \$4 million per pupil. Data on students eligible for free and reduced price lunch are from the California Department of Education.