

# TAX FACTS



Taxpayers' Federation of Illinois

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## GENERAL STATE AID FOR EDUCATION Time for an Overhaul

### Part 2 of 2

By Ted Dabrowski

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### Executive Summary

An analysis of Illinois's 2009 General State Aid for Education (GSA) budget is striking. Not for what it tells, but for what it omits.

Missing are budget line items that clearly demonstrate dramatic shifts in policy orientation - results from a decade of change to the GSA formula. Absent is the destination of up to \$1.4 billion in equalization funds that have been redirected toward other policy objectives. Omitted is mention of any winners and losers, sure to have emerged from the complex formula changes. Simply put, key changes and trends in the GSA are not visible in the state's financial reports. Consequently, they go largely unnoticed or misunderstood.

The result of these formula changes is that Illinois' key education funding program is no longer aligned with its main goal - the equalization of state funding for property-poor districts. Convolution formulas have veiled policy

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## NOTES FROM THE INSIDE. . .

By J. Thomas Johnson

This issue of Tax Facts authored again by Ted Dabrowski, builds on his previous work published in our April edition, about the changes in Illinois' K-12 State Education Funding over the last several years. We were most surprised by the impact the "Double Whammy" (PTELL) adjustment and the Poverty Grant has had on the inability to maintain funding of the foundation grant at the level proposed by the Education Funding Advisory Board through 2006 and then adjusted for inflation thereafter. Ted challenges us as to whether the results in the change in the formula due to these two "modifications" could have been predicted or was the impact an unintended consequence of what was considered a "small" adjustment. Regardless, the impact has had a significant impact on state K-12 school funding. The fact that the 23.8% increase in the Foundation grant level since 2004 has been almost completely funded by the property tax rather than state resources was a shock.

We would suggest it is time to take another look at the Foundation grant funding mechanism to have a better ability to project the future impact of these modifications on what was expected to be driven mostly by the differences in local wealth per student. The last decade has seen dramatic change predicted or not, future changes should be more transparent.

shifts in the state's education finances, while a lack of detailed reporting has buried spending trends that are incredible in any budgetary environment. The formula changes, however, raise not only the question of policy shifts, but also of resource equity. Large swings in the distribution of state resources have occurred across different regions of the state, creating both winners and losers.

How did the funding policy shift so significantly, and what changes occurred to the formulas to lead to such shifts? Were these policy shifts the result of purposeful design, or unintended consequences? And where does the money now flow, as proportionately less funds support the broader Foundation Level for all Illinois children?

This paper provides some transparency and helps answer the above questions. In particular, the analysis highlights how a pool of state funds, meant for broad redistribution and equalization, has been channeled to some high-property-wealth growth districts in the form of property tax relief. It also shows how the hyper-growth rates of property tax relief and the poverty grants have altered the dynamics of the GSA and the Foundation Level. And, importantly, it reveals where the most of the money goes.

In the last issue of Tax Facts, the GSA and the Foundation Level were introduced. The issue highlighted how GSA funds have been diverted away from equalization and toward property tax relief for school districts negatively impacted by property tax cap laws (PTELL). It showed how the amount of subsidies given to these select districts (38% of all districts) has grown by an astonishing 1,615% - from \$46 million in 2000 to \$789 million in 2009.

The issue also emphasized how laws have fundamentally changed the poverty grant formula embedded within the GSA. Dramatic

increases in the count of low-income students - along with a revamped formula - led to a 211% ramp-up in required poverty grant funding over the past nine years (from \$302 million in 2001 to \$941 million in 2009).

Statewide, Illinois' school districts have paid a steep price for these policy reorientations. In 2000, after funding property tax relief and the poverty grant, 88.5% of GSA funds were dedicated to equalization and the Foundation Level. Today, that amount is only 62%. The GSA's contribution to the Foundation Level has not grown in the past five years, despite a \$1.3 billion increase in the GSA. This GSA information presented above, interestingly, is nowhere itemized in the state's education financial reports.

To make room for the subsidies and increased grants, amounts potentially earmarked to fund the Foundation Level for all school districts have been simply forfeited. As an example, had the 2009 PTELL subsidies gone directly to the Foundation Level, and *not* to property tax relief for PTELL districts, the State could have funded an additional \$719 for every single student in Illinois. Clearly, a trade-off is occurring between these other policy objectives and a higher Foundation Level for all districts.

The extensive, yet non-transparent, transformation of the GSA speaks volumes about Illinois' education finance. Though billions more have been spent on the education of our children over the past twenty years, trying to decipher where and how the funds are spent has become increasingly challenging. The centralization of education funds has only led to confusion and disorientation about how Illinois spends its precious dollars.

## GENERAL STATE AID

A simple investigation into the 2009 budget of the \$4.6 billion GSA, the State's single-largest budget appropriation to K-12 education, will not satisfy those seeking detail. The State Education Budget does not provide any line-item breakdowns, growth rates, or geographic destinations of GSA funds. The only line item visible is the \$4.6 billion appropriation total and its change over the past few years.

The rationale for not providing more line-item detail is that the GSA is a single appropriation. Unfortunately, the situation is much more complex than that - GSA funds are widely distributed via complex and misunderstood formulas. The result is that the embedded \$789 million PTELL Adjustments and the \$941 million Poverty Grant totals are not openly accounted for. Indeed, while the Poverty Grant is described in the narrative, albeit with no line item, the PTELL Adjustment does not even merit a description.

This paper provides some transparency to the policy shifts occurring within the GSA during the past decade. In particular, the analysis highlights:

- How the centralization of state funds, a lack of transparency, and complex formulas have obscured major policy shifts.
- How a pool of state funds, meant for broad redistribution and equalization, has been channeled to select districts in the form of property tax relief.
- How the hyper-growth rates of property tax relief have altered the dynamics of the GSA and the Foundation Level.

- How changes to the Poverty Grant formula, and significant increases in the concentration of poverty, have affected the GSA.
- Where the money is going - who are the winners and losers.

### General State Aid – A breakdown

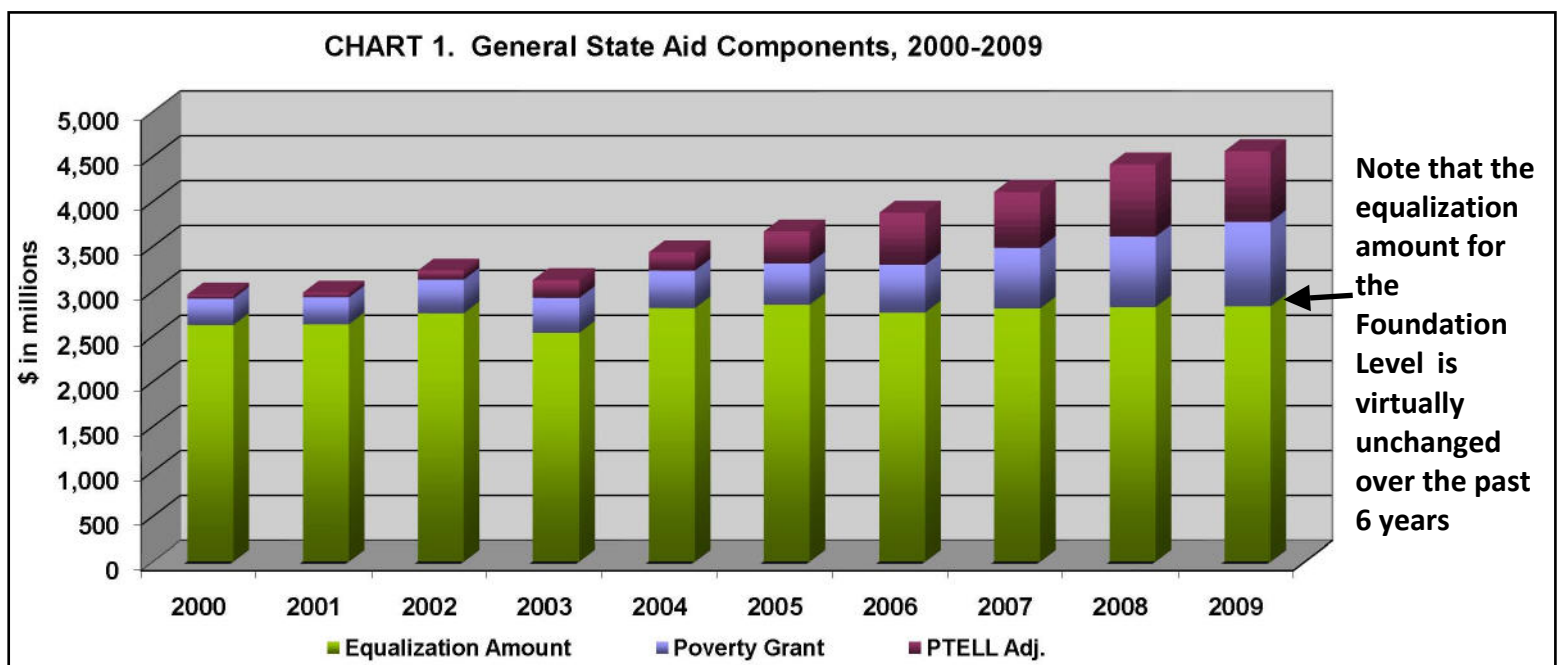
Unknowing proponents of increased education spending may be generally satisfied with the 4.9% per annum growth rate of GSA funds over the past decade – from \$2.96 billion in 2000 to \$4.56 billion in 2009. Their satisfaction, however, may be tempered when the GSA’s growth is broken-down into its key components.

Though the State Legislature appropriates the GSA as a single total, the 2009 numbers can be effectively decomposed as follows:

- \$2.8 billion in Equalization/Foundation Level funds.
- \$789 mm in PTELL Adjustments (Property Tax Relief for property tax capped districts).
- \$941 mm in Poverty Grant funds.

This breakdown is critical to understanding how policy shifts have occurred. Many education and policy experts have been led to believe that GSA funds go increasingly toward the Foundation Level and the equalization of property-poor districts. What they will be surprised to find is that almost no new State dollars have flowed to the Foundation Level since 2004.

Rather, over the past five years, almost all of the \$1.3 billion in incremental funds to the GSA have gone toward property tax relief for some high-property-wealth growth districts and toward poverty grants. In 2009 alone, \$789 million in subsidies from the GSA allowed PTELL districts to effectively maintain lower property tax levies. These PTELL districts, many of which are high-property wealth districts, have tapped state tax dollars for property tax relief, funds that would have otherwise gone to all Illinois school districts in the form of a higher Foundation Level. Likewise, significant growth in Poverty Grants has also diminished the available dollars for the Foundation Level.



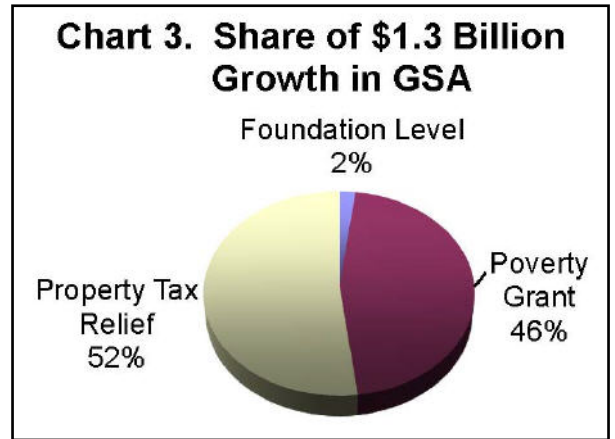
It should be no wonder, then, that EFAB's<sup>1</sup> Foundation Level recommendation has been under-funded since 2003 - it coincides with the state's increasing contribution to property tax relief and the poverty grant.

**Chart 1** exhibits GSA growth by its three major components<sup>2</sup>. Clearly, growth in the GSA has been fueled not by funds dedicated to the Foundation Level, but by growing Property Tax Relief and Poverty Grant payments. The lower green part of the column, representing funds dedicated for equalization of all Illinois students, has not grown in the past 6 years.

The fantastic nine-year growth (shown in **Chart 2**) in both the Poverty Grant (211%) and the Property Tax Relief (1,615%) have crowded out any potential growth in funds available for broader Equalization.

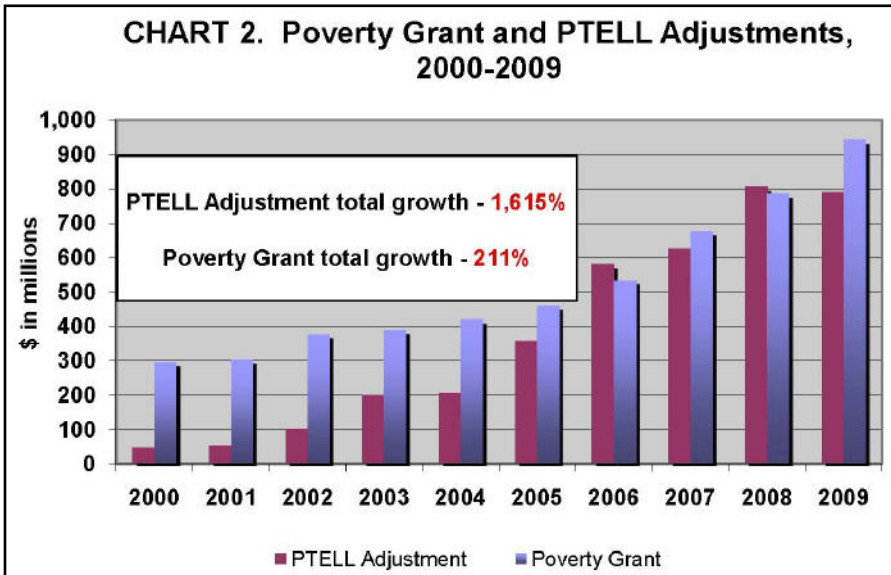
As a matter of fact, the formula changes have overtaken the GSA to such an extent that Foundation Level funding, after subtracting for

the PTELL Adjustment and the Poverty Grant, has grown by only \$20 million in the last 5 years. That represents only 2% of the \$1.3 billion growth of the GSA since 2004 (see **Chart 3**). Unfortunately, none of these trends or spending totals has been officially published in the annual report of education spending.



Of course, not everyone will be opposed to the actual findings presented above. There are plenty of proponents of property tax relief in Illinois, while there are certainly advocates for increased poverty funding in education. But the process by which these spending categories have grown, in a non-transparent, hyper-growth rate environment, diminishes the integrity of the education finance system.

Just how did the PTELL Adjustment and the Poverty Grant come to have such an influence on the GSA formula? And what are the destinations of those funds – are there winners and losers? If these funds are not individually appropriated, how is the formula attributing these funds across the State?



<sup>1</sup> A special unit called the Education Funding Advisory Board (EFAB), established by the legislature in 1997, recommends the Foundation Level.

<sup>2</sup> Detailed data and breakdown of the GSA by year provided directly by ISBE

To answer those questions, it is important to better understand the PTELL Adjustment and the Poverty Grant.

## The PTELL Adjustment – A New Policy Objective

In the 1990's, the Property Tax Extension Limitation Law (PTELL) was enacted to limit the fast growth of local property taxes. These property tax caps limit a jurisdiction's yearly tax revenue increase to the lower of 5% or the rate of inflation. Tax levies above the capped level can occur only through the passage of a local tax referendum.

While the PTELL laws were extremely successful in capping the growth of property taxes, they did nothing to curb the growth of actual spending by local districts. PTELL jurisdictions found themselves strapped for cash as salaries, pensions, and the costs of service deliveries rose significantly faster than their capped tax revenues. Despite the increased property valuations occurring in their districts, PTELL districts were restricted from taxing their local base by more than that limited by law.

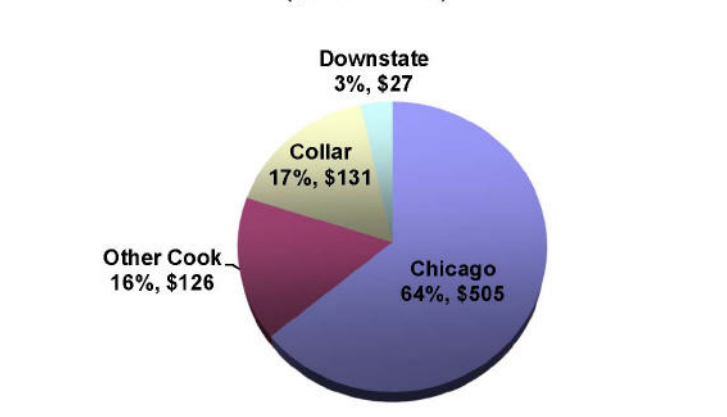
Tax relief for these districts, however, was found in the State's education formulas. In 2000, the General Assembly approved the PTELL Adjustment, targeted tax relief to those districts whose local tax revenues are capped by PTELL laws. The funds for that relief come from the General State Aid for Education. In effect, a tax swap of sorts was created for PTELL districts. PTELL districts with capped access to local tax resources are receiving a subsidy from state tax dollars. This Adjustment, and consequently state funds, is available only to the PTELL districts.

The subsidy, however, does not come in the form of a separate, transparent, and appropriated payment, but rather as an "adjustment" within the GSA entitlement calculation for each eligible district. In order to pass along the property tax relief in the form of higher aid payments, ISBE assumes in its formulas that PTELL districts have less taxable property available to them than they actually do. This assumption effectively reflects the financial impact of the PTELL law. Since GSA aid is granted in inverse proportion to a district's property wealth, the use of lower property values for a GSA district implies higher state aid

payments to that district. That is, the more property-poor the district, the more aid it should receive.

Chicago District 299, because of its size, most prominently exhibits the impact of the PTELL Adjustment. Actual 2009 numbers are used in the below example.

**CHART 4. Distribution of 2009 PTELL Adjustment (\$ in millions)**



To determine the GSA payment to District 299, ISBE assumes that Chicago has available to it only \$43.8 billion in property EAV, rather than its actual \$76.5 billion. The \$43.8 billion EAV is used to determine the available local tax resources per pupil in the District (\$4,164 per pupil in 2009), which is then compared with the Foundation Level funding amount per pupil of \$5,959. As a Foundation Grant district, District 299 qualifies for the difference between the \$5,959 and its available local resources per pupil.

As a result of using Chicago's deflated property EAV, and not its actual EAV subject to tax, District 299 was a beneficiary of \$505 million in additional GSA funding (the so-called PTELL

Adjustment). That amount was embedded in the District's \$1.15 billion of GSA funds received for the year, which also included the District's poverty grant total of \$496 million.

ISBE provided the following regional breakdown of the PTELL Adjustment in 2009 (see **Chart 4**). The amounts provided to each region are a reflection of their relative size as well as the number of PTELL districts

in each region. As can be seen clearly in the chart, there is a wide disparity in the distribution of state resources by region. Chicago is the largest beneficiary at \$505 million, while Downstate received a total of \$27 million.

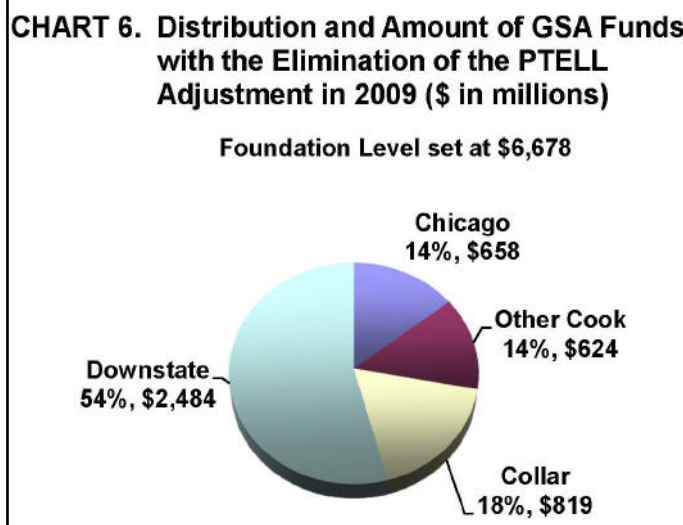
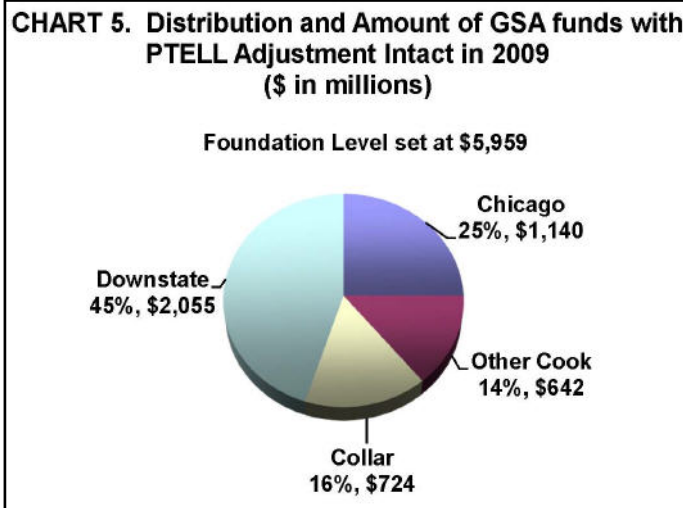
Now, consider the scenario in the absence of the PTELL Adjustment. ISBE would base its aid to District 299 using its full property EAV of \$76.5 billion dollars, and not the lower \$43.8 billion. At that level of property wealth, Chicago would become an Alternate Grant district and would lose most of its non-poverty based aid. A further detailed analysis is provided below.

Given the hyper growth rate of the PTELL Adjustment and the relative concentration of subsidies to Cook County, the following items need to be further analyzed: the

Adjustment's impact on the funding of the Foundation Level, and its influence on operating tax rates of PTELL and non-PTELL districts.

## The Impact of Property Tax Relief on the Foundation Level

To measure the negative impact of the PTELL Adjustment on the funding of the Foundation Level, ISBE was asked to calculate a pro-forma Foundation Level calculation assuming the PTELL subsidies had not existed in 2009. The below example clearly demonstrates the Adjustment's negative influence on the state's ability to increase the Foundation Level for all districts.



**Note the changes in the 2009 GSA payments to Chicago (-\$482 mm) and Downstate (+\$429 mm).**

**With the elimination of the PTELL Adjustment, the funding of the 2009 Foundation Level is increased by 12% to \$6,678.**

By using the PTELL funds for equalization, and not Property Tax Relief, the Foundation Level would have been increased by \$719 per student, a 12% increase over the \$5,959 funded in 2009. At \$6,678 per student, the State would have been within target of the \$6,999 adjusted EFAB recommendation. Clearly,

a trade-off is occurring between Property Tax Relief for tax-capped districts and a higher Foundation Level for all districts.

**Charts 5 & 6** show the impact of the PTELL Adjustment. In the first, with the PTELL Adjustment intact just as it was in 2009, the Foundation Level was limited to

\$5,959. The 2009 regional distribution of the GSA funds is as shown.

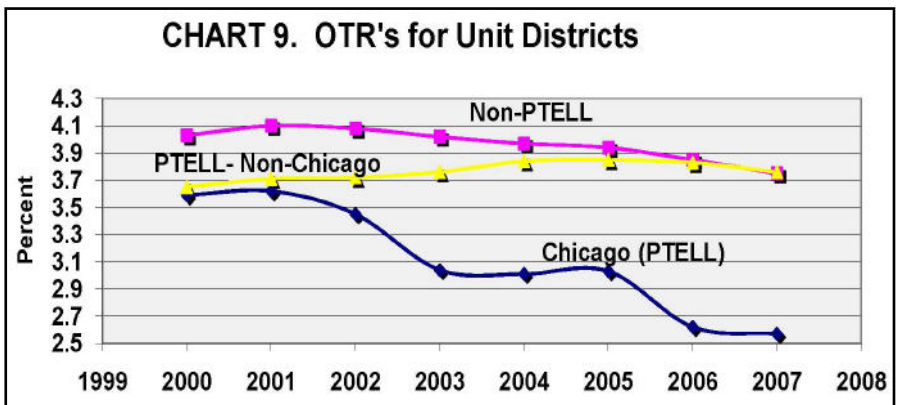
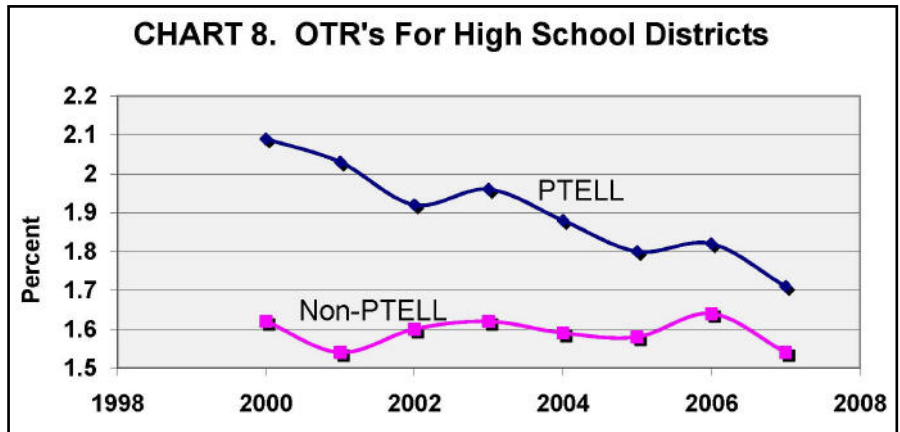
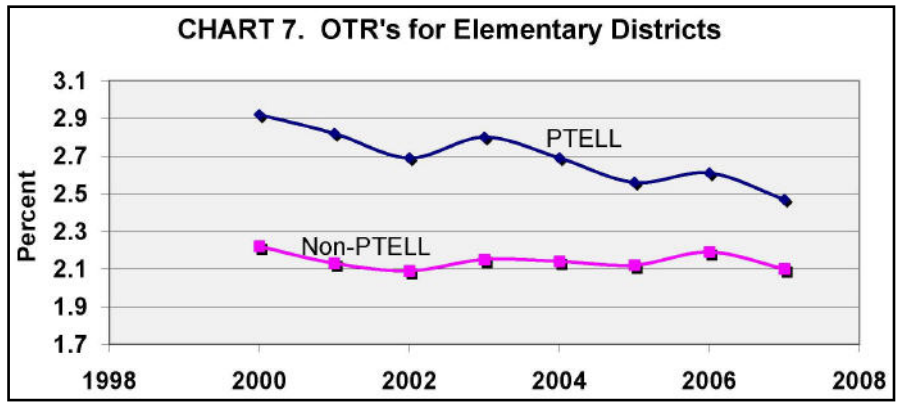
In Chart 6, the PTELL Adjustment is not paid out to PTELL districts, but is instead distributed as higher Foundation Level payments to all districts in Illinois. In this case, the Foundation Level could have been increased to \$6,678 per student.

On a net basis, Chicago loses almost \$500 million in property tax relief. Also, because Chicago is relatively property rich in a no-PTELL Adjustment scenario, it sees almost no benefit from the higher Foundation Level payments. Conversely, the property-poor Downstate gains \$429 million from the increased Foundation Level payments. These large swings in the distribution of state resources reveal how winners and losers can be created by complex formula changes.

This paper is not arguing against Property Tax Relief as an overall policy objective, nor is it suggesting that ISBE immediately cut \$500 million in education funds from the Chicago District. Rather, it is exposing how a centralized and non-transparent formula, in a dynamic economic environment, quickly yielded policy shifts in the GSA that were unseen and, possibly, unforeseen.

### Potential Impact of PTELL on Property Tax Rates

A final point in the PTELL discussion is the effect of these subsidies on the Operating Tax Rates of individual school districts. Though more significant and rigorous research needs to be performed on this subject, an initial review of the relationship between PTELL subsidies and Operating Tax Rates (OTR) points to an interesting trend. **Charts 7, 8, and 9** show how



PTELL districts have seen their OTR's fall, in percentage terms, significantly faster than those of non-PTELL districts. This is particularly true for elementary and high school districts, where EAV's have grown at similar rates over the 2000-2007 period<sup>3</sup>, though the relationship for unit districts, excluding Chicago, is less clear<sup>4</sup>.

Further analysis is needed to control for the many the variables affecting the OTR level. But the significant drops in the OTR's of PTELL

<sup>3</sup> EAV's and OTR's by district provided directly by ISBE.

<sup>4</sup> Chicago District was isolated because its OTR charge would distort what occurred in other districts.



districts (38% of all districts) raises the concern that state subsidies could be leading to diminished local tax efforts by districts benefiting from the PTELL Adjustment.

### The Poverty Grant.

Prior to changes in the GSA formula in 1999, the Poverty Grant, also known as the Supplemental State Aid, was embedded within the GSA entitlement payments. The grants to each district were calculated based on the 1990 Census Low Income Count for that district. District eligibility amounts were also dependent on the concentration level of poverty within a

given district (defined as percentage of low income students relative to Average Daily Attendance), with per-student grant amounts stepping-up as various poverty concentration

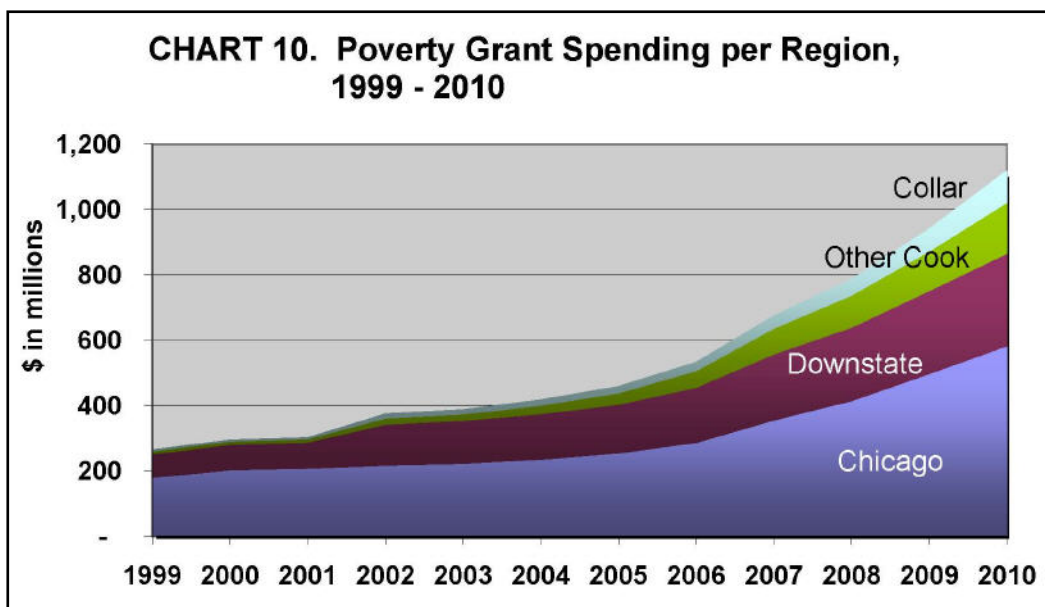
levels were reached.

Because the static 1990 Census Low Income count was used through 2003, Poverty Grant economics did not change significantly for several years, occurring only as overall education populations changed in a given district.

In 1999, however, the Poverty Grant was converted to a categorical grant to be distributed from the overall GSA appropriation. A separate appropriation for the Poverty Grant was debated at the time, but it failed to materialize. Significantly, the law changed the low-income count methodology from the old and static 1990

Census count to a new 3-year moving average based on the DHS count. The changes were to be phased in over several years starting in 2004 so that their immediate budget impact would be limited. Due to the formulaic changes, Chicago has seen its low-income population rise 72.8% from 162,752 in 2000 to 281,329 in 2010, while all of Illinois experienced a 142% increase from 328,150 to 794,637 for the same time period.

The resultant increases in the poverty count have led to significant increases in spending in all Illinois geographies. The average growth rate in spending since 1999 has been 13.9% per annum,



Average Annual Growth Rates 1999-2010
31%
30%
13%
11%

while, as can be seen in **Chart 10**, the total dollars spent have risen from \$265 million to over \$1.1 billion.

Increased populations were not the only factor contributing to the increase in spending. The formula also grants increased per-pupil spending as the levels of poverty concentration increase. The curvilinear formula has a factor that squares the concentration level of poverty, thereby increasing the per-student grant amount to districts as poverty concentration percentages increase. The formula is as follows:

Per-pupil poverty grant =  
 $\$294 + (\$2,700 * \text{poverty concentration}^2)$

and is shown in **Chart 11**.

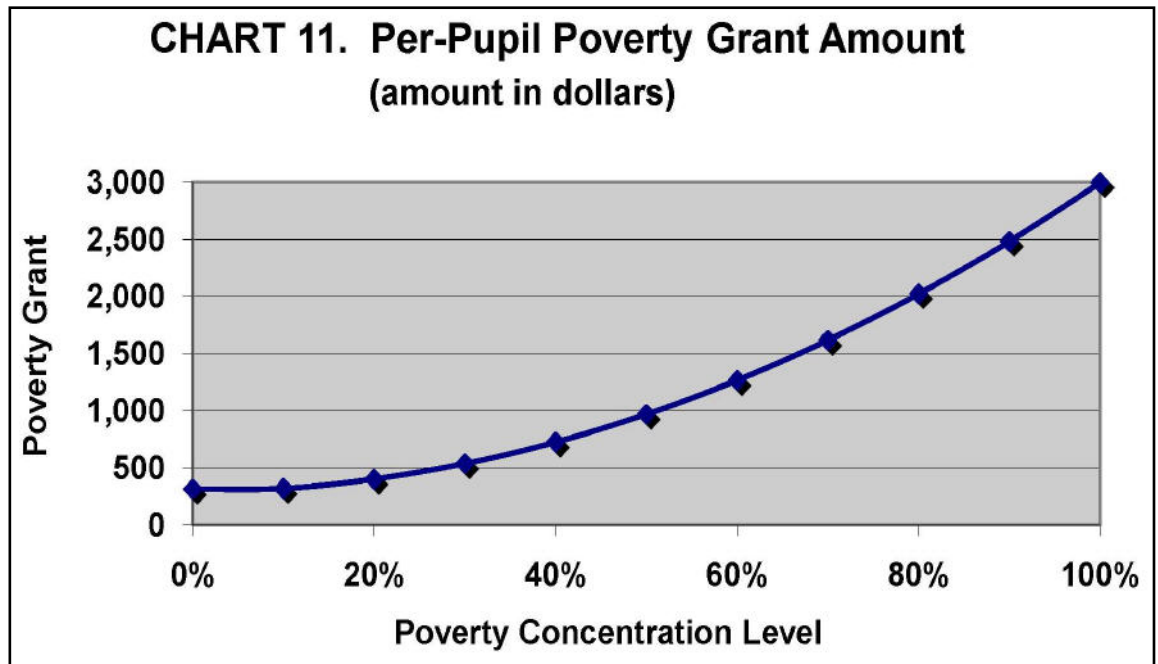
Chart 11 becomes significant when viewed in conjunction with **Chart 12**. As concentration levels in all of Illinois have increased under the new formula, the jump in per-pupil poverty grants has been considerable.

Concentrations, as shown below, have increased sizably as the DHS count methodology has fully phased in. Illinois has more than doubled its poverty

concentration to 42% in ten years, while Chicago has recently exceeded the 80% concentration level. These increases have had significant impact on the growth of the poverty grant, as

well as the reduction in funds available for equalization across all Illinois districts.

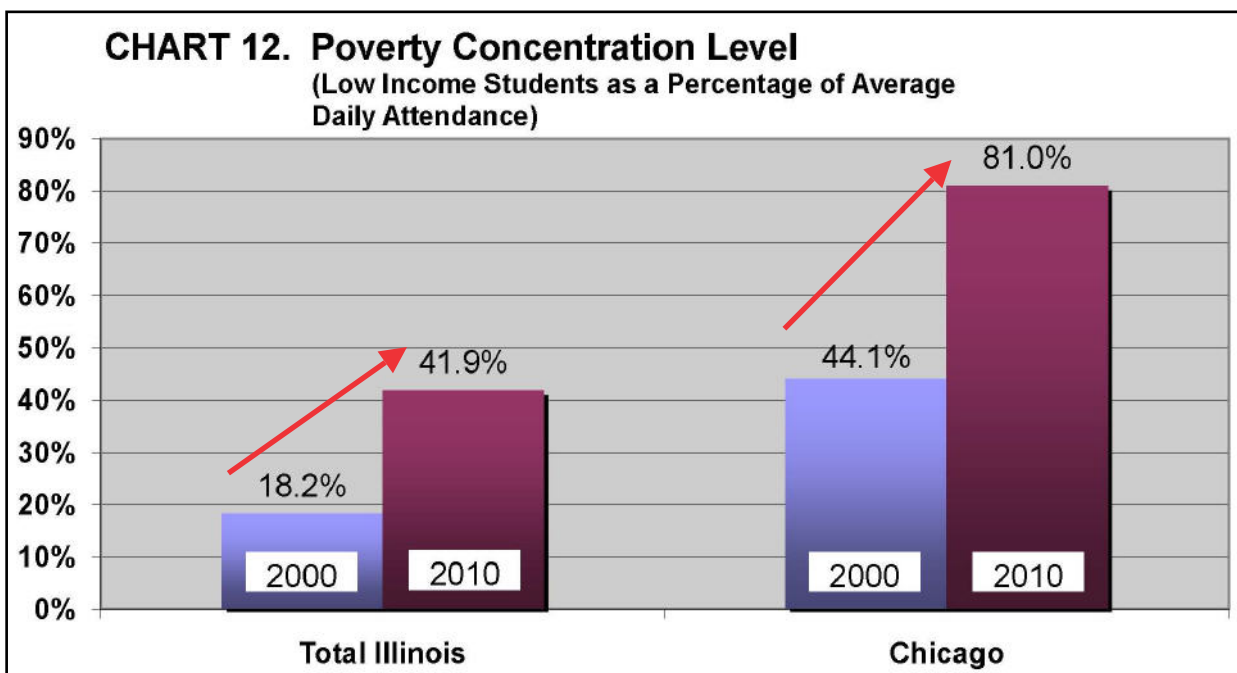
Even more, the formula measures poverty concentration as the three-year average DHS



count divided by the previous year's ADA. For those districts whose ADA populations drop in a given year, they receive increasingly higher poverty grants as a result of higher poverty concentrations. Paradoxically, for high poverty

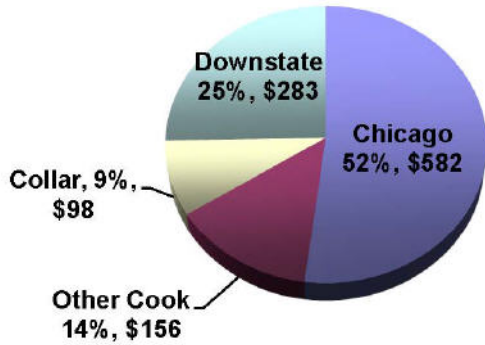
concentration schools that suffer losses in ADA, their total GSA payments can actually increase, as higher per-pupil poverty payments offset lost per-pupil foundation grant payments.

The geographic and district type

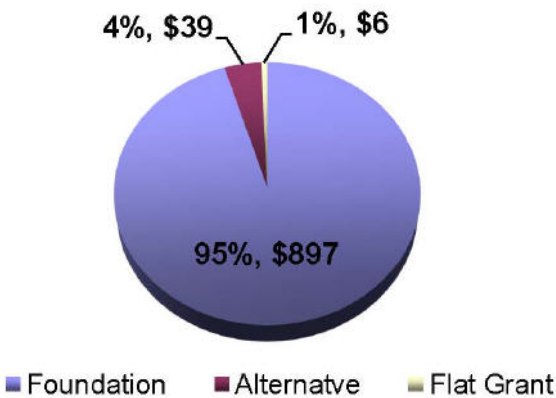


distribution of the Poverty Grant is shown in **Charts 13 & 14.**

**CHART 13. 2010 Distribution of \$1.119 billion in Poverty Grants (\$ in millions)**



**CHART 14. Distribution of Poverty Grant by District Type (\$ in millions)**



As with the PTELL Adjustment, because no separate appropriation was mandated, a similar transparency problem has occurred in the granting of poverty aid. The large increases in the poverty count, in conjunction with the sizable \$1.190 billion total Poverty Grant payment, call for crucial attention to Poverty Grants as a stand-alone line item in the budget. There is no serious budget level reporting on the Poverty Grant or how it has changed over the past decade.

### Summary

The extensive and almost stealth transformation of the GSA formula represents the ills of Illinois' education finance structure. The centralization of education funds, the use of complex formulas, and a lack of transparency have diminished the integrity of the funding process. Funding goals have gone off course, while undetectable spending items have grown at unsustainable rates.

The current crisis in Illinois provides a considerable opportunity to reform the flow of the state's education dollars. Leaders should avoid funding complexity and instead embrace simplicity and transparent reporting. By transferring funds away from the centralized bureaucracies and more directly toward students and schools, education reforms will have a greater chance of success.

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