

*(EDITOR'S NOTE: This policy brief is a revised version of the brief that was published on Jan. 22, 2020. The brief has been updated to reflect changes in AM 2433.)*

LB 974, as amended by AM 2433, would significantly change school funding in Nebraska and raises concerns about fiscal sustainability and equity in educational opportunities.

The bill<sup>1</sup> seeks to lower property taxes by reducing the taxable value of all property types for school districts, limiting school spending and increasing state aid. It would, however, be funded by projected revenue surpluses rather than new dedicated revenue streams and would make fundamental changes to the state's school funding formula that could hinder our ability to provide equitable educational opportunities for all Nebraska students. **(See a full list of the measure's proposed policy changes at the bottom of this analysis.)**

### **Banking on projected revenues is unsound fiscal policy**

Increasing state aid to K-12 education has long been considered the best way to lower property taxes in Nebraska, including being the top recommendation of the 2013 Tax Modernization Committee.<sup>2</sup> LB 974, however, would fund such increases with surplus revenues the state is projected to receive in the next couple years. It's important to remember that the projected revenue increases are just that -- projections -- and are often considerably higher or lower than actual revenues.<sup>3</sup> [Read more in our recent policy brief about revenue projections.](#)

### **Counting on one-time revenues also risky**

The recent bump in state revenues may be inflated by one-time factors, such as increases in corporate income tax receipts due to companies claiming offshore earnings in response to a 2017 change in federal tax law.<sup>4</sup> Similarly, an influx of market facilitation payments -- federal dollars paid to farmers for losses sustained from tariffs -- may also be playing a role in the surplus revenue. These payments have totaled nearly \$720 million in Nebraska<sup>5</sup> and are subject to income tax. Enacting on-going fiscal policy based on one-time revenues and increased projections is dangerous because it leaves the state with no other option but to cut services or increase other taxes and fees when revenues come in below projections in the future.

<sup>1</sup> Nebraska Legislature, "LB 974," accessed at [https://www.nebraskalegislature.gov/bills/view\\_bill.php?DocumentID=41351](https://www.nebraskalegislature.gov/bills/view_bill.php?DocumentID=41351) on Feb. 18, 2020.

<sup>2</sup> Nebraska Legislature, "Report to the Legislature: LR155 – Nebraska's Tax Modernization Committee (2013)" accessed at [https://nebraskalegislature.gov/pdf/reports/committee/select\\_special/taxmod/lr155\\_taxmod2013.pdf](https://nebraskalegislature.gov/pdf/reports/committee/select_special/taxmod/lr155_taxmod2013.pdf) on Nov. 6, 2019.

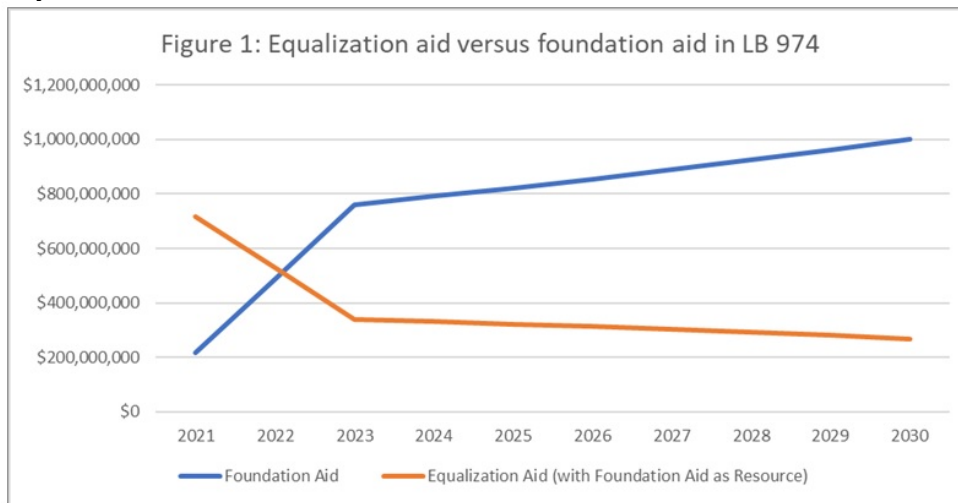
<sup>3</sup> OpenSky Policy Institute, "Policy brief -- Beware of banking on revenue projections," accessed at <https://www.openskypolicy.org/policy-brief-beware-of-banking-on-revenue-projections> on Jan. 17, 2020.

<sup>4</sup> Tax Policy Center, "What is the TCJA repatriation tax and how does it work?" accessed at <https://www.taxpolicycenter.org/briefing-book/what-tcja-repatriation-tax-and-how-does-it-work> on Jan. 20, 2020.

<sup>5</sup> U.S. Department of Agriculture, "Market Facilitation Program Data," accessed at <https://www.farmers.gov/sites/default/files/documents/MFP%20Data%20-%202001062020.pdf> on Jan. 17, 2020.

### LB 974 per-student funding component would turn K-12 aid formula on its head

A major piece of LB 974 would change the state school aid formula to provide school districts with per-student funding -- also known as foundation aid. To account for the difference in needs and resources among Nebraska school districts, the state currently utilizes an equalization-based formula to fund K-12 education. Districts that receive equalization aid have educational needs that exceed what they can raise in local resources -- namely, property tax revenue. Equalization aid helps ensure all districts have equitable educational opportunities, regardless of their local resources, and foundation aid does not consider the diverse needs of individual districts. Pulling back from the equalization-based formula and shifting to more foundation aid threatens districts with high amounts of poverty and English language learners. And as LB 974 is structured, foundation aid could rapidly outpace equalization aid growth. LB 974's foundation aid component is funded by a share of the state's net income, corporate, and sales and use tax collections, gradually increasing to equal 15% in year three and beyond.



The chart above compares the projected growth of LB 974's foundation aid component with projected growth in equalization aid starting in 2021. The chart assumes foundation aid would grow at 4%, which is about the average growth in state sales and income tax revenue in Nebraska over the past decade (2010-2019). It also assumes equalization aid would continue to increase at the 1.64% rate of growth it averaged over the same time period. But because foundation aid is considered a school funding formula resource under the bill, it would reduce equalization aid. While the bill does not indicate at what level equalization would be reduced, for this chart, we assume equalization aid is reduced by 75% of foundation aid. Under these conditions, foundation aid would replace equalization aid as the biggest component of state school aid in the second year of

implementation and continuously become a larger share of school aid over time. The actual rate at which equalization aid is reduced may end up higher or lower than 75%, but that wouldn't change the fact that foundation aid will overtake equalization aid, it only changes the timing. If the rate is lower than 75%, the shift will come later; if the rate is higher than 75%, it will come sooner. This would be particularly detrimental to Nebraska's largest school districts, which rely heavily on equalization aid, educate the majority of Nebraska's students and have the greatest educational needs.

### **Valuing land different for tax purposes adds unpredictability to school funding, creates revenue losses for many schools**

LB 974 would reduce the taxable value of real property and shift funding from a stable revenue source, property taxes, to an unpredictable revenue source, state aid. The state has changed the school funding formula regularly, often resulting in less state aid to schools and making state aid unpredictable over time.<sup>6</sup> Also, OpenSky analysis shows that many districts will lose more revenue under the measure than they would be able to recoup from the increased state support because of their decreased assessed valuation.

### **Linking school spending growth to CPI would exacerbate budget uncertainty for schools, ignores spending realities**

The proposal also would limit district spending and maximum levies to the Consumer Price Index (CPI), so long as it does not exceed 2.5%. The CPI -- a measure of the national average change in the price paid by urban consumers for common household purchases -- is a poor metric on which to base school spending because it does not reflect the factors that drive school spending. The bulk of school spending is on salaries -- 55% for Nebraska schools in FY 2017-18<sup>7</sup> -- but CPI does not factor in income growth. As a result, chaining school spending to CPI would omit a large cost driver in school budgets. Also, limiting school spending to between 0 and 2.5%, would likely squeeze school budgets over time. Public school spending in Nebraska averaged 3.5% growth from FY 2007-17 and CPI during that same timeframe only grew an average of 1.6%.<sup>8</sup> [Read more about CPI in our recent policy brief.](#)

### **Revenue recoup measures not guaranteed to hold school districts harmless**

Transition aid and a levy exclusion would be available under LB 974 but neither guarantees schools will be held harmless. Transition aid would only be available for

<sup>6</sup> OpenSky Policy Institute, "Investing in Our Future: An Overview of Nebraska's Education Funding System (P. 7-8)," updated September 2018, accessed at [https://www.openskypolicy.org/wp-content/uploads/2018/12/OSPI007-03-2018-EDUCATION-PRIMER-UPDATE\\_singles-1.pdf](https://www.openskypolicy.org/wp-content/uploads/2018/12/OSPI007-03-2018-EDUCATION-PRIMER-UPDATE_singles-1.pdf) on Jan. 21, 2020.

<sup>7</sup> OpenSky Policy Institute, "Policy brief -- A look at school spending in Nebraska," accessed at <https://mailchi.mp/openskypolicy.org/policy-brief-a-look-at-school-spending-in-nebraska?e=5ec57c7887> on Jan. 17, 2020.

<sup>8</sup> Federal Reserve Bank of Minneapolis, "Consumer Price Index, 1913-," accessed at <https://www.minneapolisfed.org/about-us/monetary-policy/inflation-calculator/consumer-price-index-1913-> on Jan. 17, 2020.

three years and it would not be guaranteed for any school at any amount. Also, the transition aid:

- Would only replace lost revenue relative to the prior year and not allow for the growing needs of a district;
- Would only be available to districts with a combined building and general fund levy of \$1.05 or greater and would decline to 75% minus 1% of the prior year's revenue in year two and 50% minus 2.5% of the prior year's revenue in year three; and
- Would require an appropriation. As a result, school districts are not guaranteed to be held harmless by LB 947.

The bill provides for a levy exclusion beginning in 2021-22 that would only allow school districts to recoup 100% of any decrease in certified state aid when compared to the January estimate. Districts would need a supermajority vote of their school boards to take advantage of the levy exclusion. School districts that have passed a levy override at an election prior to the passage of LB 974 would have access to a levy exclusion for the period of years applicable to their override equal to the loss of revenue in property valuations that occurred after the passage of the levy override.

### **Schools already subject to tax and spending lids**

Nebraska school districts already are subject to limits on how much they can tax and spend and they are governed by elected boards that work hard to keep property taxes as low as possible while still meeting the needs of their students. In recent years, state school aid has been constrained as a share of the economy and this has contributed to increased reliance on property taxes to fund K-12 education. The additional constraints on taxes and spending will likely force schools to make damaging cuts to the services they provide to Nebraska's students.

### **Conclusion**

It is important that Nebraska address its longstanding struggle with high reliance on property taxes to fund K-12 education, which has been particularly difficult on agricultural landowners. LB 974, however, is likely an unsustainable measure that puts the onus of providing property tax relief on the backs of Nebraska's public school children, particularly those in school districts with the highest educational needs. Fortunately, there are better options in front of lawmakers in terms of reducing our need to rely on property taxes to fund our state's vital investment in K-12 education.

---

### **What the measure does**

LB 974, as amended by AM 2433, makes multiple changes to Nebraska's school finance system and uses projected surplus revenues as a funding source to provide property tax

relief. According to the fiscal note,<sup>9</sup> the measure is estimated to cost more than \$597 million over the next three years, exceeding the \$442 million projected surplus in the Appropriations Committee's Preliminary Report.<sup>10</sup> Even with the amendment, the cost is likely to exceed \$500 million over the next three years. The bill would:

- Lower taxable value of agricultural land both in and out of the school funding formula by 20% over three years for purposes of school property taxes;
- Lower taxable value of residential/commercial property both in and out of the school funding formula by 13% over three years for purposes of school property taxes;
- Provide foundation aid equal to up to 15% of state net sales/income tax revenue;
  - 5% in year one; 10% in year two; 15% in year three and beyond;
  - Allocates aid on a per-student basis with each school receiving at least 15% of its basic funding;
- Limit school spending growth to the Consumer Price Index (CPI) -- so long as CPI is between zero and 2.5% -- starting in year one and modifies maximum levy in year four;
- Starting in FY24, it would change the maximum levy to the lesser of \$1.05 or the local formula contribution (valuation growth multiplied by the CPI, so long as the CPI is between zero and 2.5%);
- Eliminate the averaging adjustment and allocated income tax;
- Change the calculation of and reduces net option funding;
- Reduce the building fund from 14 to 6 cents but allow districts to increase the fund to 14 cents with a vote of the people; and
- Allow schools to make up any decrease in certified state aid, as compared to the January estimate, with a vote of at least  $\frac{2}{3}$  of the school board.

Also, under LB 974:

- Schools with unused budget authority -- those that haven't increased their general fund expenditures in line with their ability to do so -- would lose any accumulated authority prior to school FY21, restricting school districts with levy authority from spending increased state aid; and
- Districts may receive three years of decreasing transition aid for schools with combined building and general fund levies at \$1.05 or greater that lose revenue year over year during those three years.

[Please read our education finance primer, "Investing In Our Future," to learn more about these components of Nebraska's K-12 funding system.](#)

<sup>9</sup> Nebraska Legislature, "LB 974 Fiscal note," accessed at [https://www.nebraskalegislature.gov/FloorDocs/106/PDF/FN/LB974\\_20200121-114123.pdf](https://www.nebraskalegislature.gov/FloorDocs/106/PDF/FN/LB974_20200121-114123.pdf) on Feb. 12, 2020.

<sup>10</sup> Nebraska Legislature, "Appropriations Committee Preliminary Report," accessed at <https://www.nebraskalegislature.gov/pdf/reports/fiscal/2020prelim.pdf> on Feb. 18, 2020.