

Issue Paper: Reforming Oregon's Local Option Process

Background

THROUGH MOST OF OREGON'S HISTORY, school funding was local. In 1989, just before the passage of Measure 5, the state provided just 25% of K-12 funding – the second lowest share among the fifty states and well below the all-states average of 48%.

Localities varied widely in their willingness to fund schools. Some districts were funded at twice the per student level of similar districts elsewhere in the state. Despite these differences, the Oregon Supreme Court upheld the system because the differences were created by local voters who chose to tax themselves more.

The state aid formula (the Basic School Support Fund) contained an equalization component, but it was poorly funded and only benefited the most needy districts. In the most comprehensive analysis of the Oregon system (which led to a text on the topic) funded by the 1977 Legislature the authors laid out the case for equalization in a local system.

In effect, equalization under the Oregon system would mean equality of opportunity to provide additional programs above the state "foundation level." Some districts had more property wealth than others due to greater commercial development, the presence of a large industrial plant or utility, or valuable natural resources. Although communities should be free to choose to fund schools above that level (and parents to "vote with their feet" by moving to a like-minded community), communities should not have to pay a higher price or tax rate to get the same relative level of funding.

Legislative discussions of schools during this period typically involved programs rather than outcomes. For example, the Legislature would periodically consider defining "basic education" to help make funding decisions. These discussions typically considered questions such as, "Is Art part of a basic education?" rather than any discussion of the outcomes that could be achieved at a given level of funding.

Under this system, many schools were relatively well-funded and state and local taxes relatively high. In 1990-91, Oregon state and local taxes were 12th highest in the country as a share of income.

Measure 5 and School Reform

Two events that occurred almost simultaneously in Oregon changed this discussion radically – voter passage of Measure 5 in 1990 and legislative adoption of school reform.

Measure 5 phased in an absolute limit on school property taxes. By 1995 every property in the state paid \$5 per \$1000 for school operations and local voters could not impose higher taxes to fund their local schools. Foreseeing this, the 1991 Legislature consulted school finance experts and concluded there was no legal or political basis to continue the wide variation in

school funding. Thus they adopted a new funding formula that explicitly equalized K-12 funding and took other steps (such as extending community colleges across the state) to equalize services.

The 1991 Legislature also passed school reform that set uniform student achievement standards. In short, Oregon almost overnight shifted from a locally funded school system that defined its mission in terms of programs to a state with a state-defined set of outcomes and no local ability to augment state-set funding levels.

Measure 50

Measure 5 cut school operating property taxes from \$1.5 billion in 1990 to \$800 million by 1995. As Measure 5 approached full phase in 1995, property tax activists feared that rapid property value growth would cause property taxes to quickly rise again. In 1996 voters approved Measure 47 - an initiative that further rolled back property taxes and limited their growth. The measure was poorly crafted and unclear in many respects. Although the measure's creator said it was not his intent, the language was interpreted to allow local voters to approve exceptions to Measure 47's limits, but not to Measure 5's. Thus was born the local option. The voters subsequently approved Measure 50, which replaced Measure 47, retaining the local option in the process. The local option permits local voters to impose a tax in the "gap" between Measure 50 and Measure 5.

Current Local Option Not Based on Any Rational Design

The primary purpose of Measure 5 was to cut taxes. Its effect on the distribution of school funds was only widely appreciated as the legislature began its implementation. The local option in Measure 50 was an accident not intended by its creator. As the chart below shows, the potential tax it permits varies widely among districts. Even

after equalization, eight districts have a maximum yield of under \$100 per student while 15 can generate over \$700 per student. This report examines what a local option would look like if it were based on a set of equity principles.

PRINCIPLES

This section proposes three principles upon which to analyze local option proposals. In the real world, a specific choice may not fully comply with all these principles, but they provide standards to analyze each option.

The state funds a foundation level for all districts. The local option allows local voters to fund their schools above that level.

Most can support a general statement like this. The difficulty is in the details. The temptation is to say this means the state funds an adequate level for all districts. Unfortunately, there is no consensus on what is "adequate". To some, "adequate" is what you can get, given what you can afford and are willing to pay for. Under this approach, the local option seems desirable. There are clearly widely varying views among communities of what each is willing to pay for. Why shouldn't each community be allowed to seek its own level?

To others, "adequate" is what it costs to get all students to the state achievement goals or to achieve some other uniform standard. This approach typically allows at most a limited local option until adequate funding can be achieved statewide. However, if funding remains below this level for an extended period, this view is hard to sustain. Either the state is not committed to reach the goals or it believes the current funding is adequate to reach them. If the state and its voters consistently fund schools at a given level, in some sense they have deemed it to be adequate, no matter how difficult it makes achieving our goals or how much some of us would disagree.

The “price” of augmenting state funding should be equalized.

Almost all states allow communities to choose to pay more to get more school services, usually through the property tax. They also have some method for adjusting for differences in property wealth. The notion is that a community should not be able to buy more than others because it has a larger tax base, particularly if the larger tax base is supported by customers outside the district. For example, a district should not be able to raise more from the property tax because a metropolitan downtown, a regional shopping center, or a large utility plant happens to be located in the district.

These adjustments typically provide some additional funds or guaranty to property-poor districts. For example, a district that imposes a given tax rate will be guaranteed that they will raise at least a minimum revenue from that rate. If the local tax base fails to produce the guarantee, the state provides the difference.

Costs should be imposed on the decision-maker.

A basic premise of the “vote with your feet” notion is that those who choose to get the benefit of locating in a community also bear the costs. The property tax is the primary tax imposed by local government in part because it is difficult to avoid. This also means that the state equalization system should not create a situation where voting for a higher levy is entirely “free” to the local residents due to a tax limitation.

CURRENT LOCAL OPTION

Calculation of local option tax

The mechanics of the current local option is most easily shown by example. The box below shows an example school tax calculation for a \$100,000 home. The example assumes the assessed value of the

home is \$80,000 and the permanent school rates are \$5.50 per thousand of assessed value. These are typical rates, although they vary widely.

LOCAL OPTION TAX ON \$100,000 PROPERTY

Assumptions

Real market value	\$100,000
Assessed value	\$80,000
M50 permanent school rates	\$5.50 per thousand
Local option approved rate	\$2.00 per thousand
Permanent tax calculation	
Measure 5 limit	\$500
Permanent rate tax	-\$440
M5/M50 “gap”	\$60
Local option tax calculation	
\$2 local option rate	\$88
Local option actual tax	\$60

On this property, the Measure 5 school limit is \$500 (\$5.00 per thousand of real market value). The permanent school rates impose a \$440 school tax (\$5.50 per thousand of assessed value). This is \$60 less than the Measure 5 limit. The \$60 is often called the “gap” between Measures 5 and 50.

If voters approve a local option, it can be imposed in this gap, but it cannot cause the total tax to exceed the Measure 5 limit. In this case, the \$2 local option rate would impose an \$88 local option tax. However, you cannot tax more than the “gap”, so the local option tax on this property is limited to \$60.

Each property within a school district has a different gap. Some, typically utility, industrial, and business personal property, have no gap at all while others, typically properties whose real market value has grown rapidly, have large gaps. Furthermore, the total gaps of school districts vary widely.

Limits on local option

There are constitutional and statutory limits on school local options. The major constitutional limits are that:

- The tax on any property cannot exceed the Measure 5 limit
- A local option levy for operations cannot run longer than 5 years
- A local option levy for capital purposed cannot run longer than 10 years or the useful life of the project, whichever is less.
- If the vote is not at a general election, a majority must vote “yes” and at least 50% of eligible voters must vote for the tax to be approved.

In addition, the legislature has limited the amount that a district can generate from a local option tax to \$750 per weighted student or 15% of the districts school fund allocation, whichever is less.

Equalization of the local option levy

The state equalizes the local option levy by adjusting for differences in property wealth based on a system used in Kansas. It guarantees that a district that votes to impose a local option tax will raise at least what it would raise if its assessed value per student were equal to the “75th percentile” district. The “75th percentile” district is the district that is richer than 75% of all districts and poorer than 25% of them.

LOCAL OPTION ALTERNATIVES

Raising the current local option limits

The 2003 Legislature raised the local option limits to their current level. Raising these limits further is attractive because it can be done by the Legislature without asking voters to amend the Constitution.

However, as the chart earlier in this report showed, most districts do not have enough gap to impose a tax up to the current limits. Thus we have already stretched our principles significantly. Raising the limits further will create an even larger variation in the amounts

districts can raise. The variation is sustained by the fact that the equalization formula adjusts for differences in property wealth, but does not adjust for gap differences. However, if we adjusted the formula to accommodate gap differences it would create situations where local voters would pay very small portions of the levy.

In short, raising the current limits will not improve the current situation and, arguably, could make it worse.

Constitutional Amendment to Levy Outside Measure 5

Oregon’s constitutional property tax system has been created by individual initiatives that had specific goals that often failed to consider the implications for the entire system. As a result, the system is hopelessly complicated and often seems to be working at cross purposes. Thus there are many constitutional changes that arguably would improve the system, such as returning to market values, recrafting Measure 5 to be based on assessed value, or applying limits district wide rather than on each property.

As attractive as those options might be, this section is limited to discussions of allowing communities a local option without changing the rest of the system.

Theoretically, one could either allow a locality to increase their \$5.00 per thousand Measure 5 limit or allow a levy outside the limit. However, locally increasing the \$5.00 limit would not directly increase revenue retained by the district unless accompanied by a local option levy. Raising the limit would also affect permanent rate collections of the ESD and community college in the area in ways that might be hard to communicate. Finally there appears to be no advantage to this approach unless one wants to take on a more extensive system reform.

A local option levy outside Measure 5 could be imposed on either assessed or market value. A levy based on assessed value would:

- Be like all other levies in the system
- Maintain the current distribution of the tax burden which protects property that has grown rapidly in value (much of it residential)
- Impose any additional tax on all property roughly proportional to the current distribution
- Raise less revenue than the same rate on market value
- Grow more slowly than a levy based on market value.

By contrast, a levy based on market value would be the only one in the system, would shift the burden to properties growing in value, and would raise more revenue than the same rate imposed on assessed value.

On balance, imposing the rate on assessed value is recommended. If the revenue yield is an issue, the amendment could permit a slightly higher rate. In 2003-04, a \$2 rate in the 75th percentile district would have produced revenue of about \$660 per weighted student.

Taxes other than the Property Tax

Unlike cities and counties, school districts have only taxing powers that are granted to them by state statute. Schools have traditionally relied on the property tax for local funding. In 1995, during the period that Measure 5 prohibited any local property tax option, a working group of the Senate Interim Committee on Finance and Tax Policy looked at creating a local option using an income or sales tax. They settled on an income tax as the most likely alternative, but the passage of Measure 47 overwhelmed any consideration of the idea.

Some cities and counties have used their taxing powers to impose taxes to benefit schools. Multnomah County imposed the state's first local income tax. Ashland imposed an activities tax on tourist businesses to benefit student activities. In

general, the only reason to impose these taxes through a city or county is that they have the power to tax that schools lack. Since city and county boundaries often are not the same as school boundaries, using the city or county power can give rise to anomalous situations that are difficult to rectify. If an income or sales tax local option is desirable, the Legislature can grant that power to school districts. The state, city, or county could do the actual tax collection through intergovernmental agreement.

Sales tax

The primary benefit of using a sales tax is that it would help balance the tax system. Oregon currently imposes no general sales tax. Appropriately constructed, a relatively small rate would raise significant revenue. The most significant liability is that a sales tax, perhaps more than any other tax, would violate the principles above. Some school districts contain virtually no retail activity while others have much more than supported by their local residents. A sales tax based local option thus would require substantial equalization. In addition, a sales tax imposed in only one or a few districts is easily avoided by those who live in the benefited area. Finally, there currently is no mechanism to collect the tax. These issues steered the 1995 legislative workgroup to an income tax.

Income tax

The income tax has all of the benefits that the sales tax lacks. An income tax imposed on residents (as opposed to those working in the area) is directly imposed on those living in the benefited area and arguably needs less, if any, equalization than the traditional property tax. However, Oregon's income taxes are already high. Imposing even higher taxes exacerbates the economic distortion caused by an imbalanced tax system. §

