REVISED

Department of Planning and Budget
2012 Fiscal Impact Statement

1. **Bill Number:** HB421

House of Origin	☒	Introduced	☐	Substitute	☐	Engrossed
Second House	☐	In Committee	☐	Substitute	☐	Enrolled

2. **Patron:** Watts

3. **Committee:** Appropriations

4. **Title:** Standards of Quality; apportionment of state and local share.

5. **Summary:** Directs the General Assembly, in apportioning the state and local share of the costs of meeting the Standards of Quality, beginning July 1, 2012, to implement a formula that determines each locality's ability to pay based on the ratios of (i) the reimbursement payment made to the locality for providing tangible personal property tax relief to the reimbursement payments made statewide for providing tangible personal property tax relief; (ii) the total value of real estate in the locality adjusted by the average of the cost of competing index if used for instructional personnel and for support positions, to the statewide value of real estate per person; (iii) local one percent sales tax revenue collected by the locality to the statewide total local sales tax revenue collected; (iv) the assessed value of the personal property taxed by the locality to the statewide assessed value of the local personal property tax; and (v) revenue collected from local lodging, local cigarette, and local meals taxes to the revenue collected statewide from such local lodging, cigarette, and meals taxes.

6. **Budget Amendment Necessary**: Yes. If the methodology for the composite index calculation is modified pursuant to this legislation, the budgeted values contained in Item 139 of House Bill 30/Senate Bill 30 would need to be revised accordingly. In addition, the existing budget language detailing the composite index calculation would need to be revised to conform to the provisions of this legislation.

7. **Fiscal Impact Estimates:** Preliminary. See item 8.

8. **Fiscal Implications:**

   The fiscal impact for this bill has been revised from the original version issued on 1/24/2012 based on revised calculations provided by the Department of Education.

   This legislation establishes a new methodology for calculating the composite index of local ability-to-pay, which is used to determine the state and local shares of Direct Aid to Public Education accounts. The current formula uses three inputs – true value of real property, adjusted gross income, and taxable retail sales – to calculate the overall ability of a school division to pay for K-12 education. These factors are considered a measure of "wealth" for each division. Under this bill, four new factors would be introduced in the formula while adjusted gross income and taxable retail sales would be eliminated.

The first data element to be used is the reimbursement payment to the locality from the state for providing tangible personal property tax relief (i.e., car tax) compared to the total reimbursement payments made statewide. Note that the values of such payments made to towns in the Commonwealth have been excluded from this data element for this estimate. This is the only data element that does not include the value of towns in the total figures because it was not readily available for inclusion in the formula; however, the total value of towns is less than 1% of the overall total for reimbursement payments. It is anticipated that the data for towns could be included in a later estimate.

The second data element included in the proposed formula is the total value of real estate in the locality adjusted by the average of the cost of competing index if used for instructional and support positions compared to the statewide value of real estate. There are two existing data sets that would satisfy this requirement: true value of property and fair market value of property. It is unclear which data set the patron intended to use; therefore, this estimate assumes that true value of property, which is used in the current methodology, will continue to be used in the new formula. In order to adjust the values by the *average* of the cost of competing index, this estimate assumes that the intent of the bill was to use only the cost of competing rates for instructional positions (full rate of 9.83%; phased rate of 2.46%) for applicable divisions; the cost of competing adjustment for support positions was eliminated in the Governor's introduced budget (HB/SB 30). The legislation does not clarify whether the true value of property values for applicable divisions should be adjusted up or down by the average of the cost of competing index. If true value of property is adjusted up for the divisions that receive a cost of competing adjustment, those divisions would appear wealthier compared to the rest of the state and would, therefore, receive less in state funding. In contrast, if true value of property for those same divisions is lowered by the average of the cost of competing index, those divisions would appear poorer compared to the rest of the state and would, therefore, receive more state funding.

The third data element to be added is the local 1% sales tax revenue collected by the locality compared to the statewide total local 1% sales tax revenue collected.

The fourth data element included in the new formula is the assessed value of the local personal property taxed by the locality compared to the statewide total assessed value of the local personal property tax. This data element is also referred to as the value of tangible personal property, which generally includes items such as motor vehicles, watercraft, aircraft, farm animals and machinery, business property, and household goods.

Finally, the fifth data element added to the new formula is revenue collected by the locality from local lodging, local cigarette, and local meals taxes compared to the total revenue collected statewide from local lodging, local cigarette, and local meals taxes.

The current composite index methodology assigns a weight of 0.5, 0.4, and 0.1 to true value of property, adjusted gross income, and taxable retail sales, respectively. Under the new methodology proposed by this legislation, no weights have been assigned to the five indicators of "wealth" for each division; therefore, this estimate does not assume any weighting of the five data elements.

Furthermore, the new formula would divide the sum of the five ratios described above for each division by the locality's 1) population estimate and 2) average daily membership. The resulting per capita ratio for each division would then be multiplied by .3333 while the locality's ratio calculated on the basis of average daily membership would be multiplied by .6667. Note that the current language in the bill uses the values of "0.66" and "0.33" as the multipliers for the per capita and average daily membership ratios. This estimate assumes that the intent is to use the values that exist in the current formula, which add to 1.0. The sum of these two ratios by division is then weighted by the average local share of 0.45 and the resulting value is the local composite index of ability-to-pay. It should also be noted that the bill does not mention the final multiplier of 0.45 for the average local share, which exists in the current formula. If the intent of this legislation is to eliminate the multiplier for the average local share, all composite index values would increase by 122 percent, resulting in an additional savings to the state.

Finally, this bill requires that the new composite index formula become effective on July 1, 2012, or fiscal year 2013.

Based on the provisions of this bill and the assumptions described above, the resulting state fiscal impact in fiscal year 2013 would be a net annual savings of approximately $2.8 billion. Additionally, approximately $179 million in Lottery funds would be saved due to the reduction in state costs for Lottery funded programs and thus could be made available for other Direct Aid costs or provide an overall increase in funding.

The savings amount is based on the interpretation that no weights should be applied to the five data factors outlined in the legislation; however, if the assumption was modified to weight each factor equally at 20%, the results would be vastly different. In this case, there would be an overall state savings of approximately $8.3 million in fiscal year 2013 and $5.5 million in fiscal year 2014, including any unallocated balance in Lottery funds. Moreover, under this scenario, counties and towns would gain approximately $285 million in fiscal year 2013 and $287 million in fiscal year 2014; whereas, cities would lose approximately $294 million in state funding each year. The bill provides no direction on how the five factors should be weighted so it is unclear if the intent would be a weighting value other than 20% for each factor.

It should also be noted that the current methodology for the composite index of local ability-to-pay exists in the appropriation act, not the Code of Virginia. Therefore, unless the budget language is modified to match the provisions of this bill, in the final budget approved by the 2012 General Assembly and signed by the Governor the current methodology would continue to be used because the budget language would prevail.

9. **Specific Agency or Political Subdivisions Affected:** Department of Taxation, Department of Education, and local school divisions.

10. **Technical Amendment Necessary:** Yes. The legislation should be amended to clarify how to apply the average of the cost of competing index to the true value of property data. In addition, the legislation should specify the weights to be assigned to each of the five data elements. Finally, the legislation should clarify whether the final multiplier of 0.45 for the average local share should be included in the new methodology.

11. **Other Comments:** None.

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c: Emily Webb