

ANNUAL REPORT ON FISCAL CAPACITY

TENNESSEE ADVISORY COMMISSION ON
INTERGOVERNMENTAL RELATIONS

August 30, 2016

Four Steps in Determining BEP Funding

1. **Basic Education Program Funding Formula:** Establishes total amount needed by each school system
2. **Local Share, State Share:** Set by law to divide responsibility between the state and local governments
 - **Instructional salary and wages costs:** 30% local, 70% state
 - **Instructional benefit costs:** 30% local, 70% state
 - **Other classroom costs:** 25% local, 75% state
 - **Non-classroom costs:** 50% local, 50% state
 - School system will receive no less than a 25% state share in non-classroom components
3. **Fiscal Capacity:** Used to allocate local share among counties
4. **State makes up the difference:** total cost of the BEP minus the local share for each school system

Instructional component split beginning 2016-17

50-50 TACIR-CBER average codified

Fiscal Capacity

- Answers the question: How much must each local government contribute to the BEP?
- Measures: The potential ability of local governments to fund education from their own taxable sources, relative to their cost of providing services.
- County-level model: All systems within each county pay the same percentage of their BEP allocation.

Method

- A set of averages drawn from actual tax bases, income, etc. is compared with actual revenue.
- The amount of weight to give each factor is determined by estimating the statistical relationship between them.
- Multiple regression analysis
 - a common statistical method used to understand relationships among factors for a wide range of issues
 - Simultaneously compares all variables for all counties to determine how much weight to give each factor
- Weights are multiplied by the factors for each county to estimate potential local revenue for each of the 95 counties.
- Actual revenue is used as a control.

Factors Used to Determine Fiscal Capacity

- **Own-Source Revenue Per Pupil:** The actual amount of money local governments raise to fund their schools divided by enrollment (average daily membership(ADM)), the control factor that keeps the estimates within the bounds of what local governments actually do.
- **Taxable Sales Per Pupil:** The locally taxable sales for the county-area divided by ADM. This is a measure of the local ability to raise revenue.
- **Equalized Property Assessment Per Pupil:** The total assessed property value for the county-area, equalized across counties using appraisal-to-sales ratios, and then divided by ADM. This is also a measure of the local ability to raise revenue.
- **Equalized Residential and Farm Assessment Divided by Total Equalized Assessment (Tax Burden):** A proxy for a county's potential ability to export taxes through business activity—the higher this number, the lower the level of business activity and the higher the risk of heavy tax burdens on county residents.
- **Per Capita Income:** A proxy for county residents' ability to pay for education and for all other local revenue not accounted for by property or sales taxes.
- **ADM Divided by Population (Service Burden):** A reflection of spending needs. The larger the number of public school students per 100 residents, the greater the fiscal burden for each taxpayer.

Effect of Changes in Fiscal Capacity Factors

The relationship between fiscal capacity and specific variables (other things being equal)

Factor Increases...	Effect of Fiscal Capacity	
Property Tax Base Increases	Fiscal Capacity Increases	↑
Sales Tax Base Increases	Fiscal Capacity Increases	↑
Per Capita Income Increases	Fiscal Capacity Increases	↑
Residential/Farm Share of Property Increases	Fiscal Capacity Decreases	↓
Service Burden Increases	Fiscal Capacity Increases	↑

The expectation is that increased service burden will **decrease** fiscal capacity.

Bureau of Economic Analysis' Revisions: Per Capita Income

- The BEA revised per capita personal income (PCI), one of the variables used to calculate the index, by incorporating new farm and journey-to-work data as well as new data from the Internal Revenue Service for dividends, interest, and rent.
- The revisions were larger than normal, averaging \$1,290 in magnitude (2016-17 fiscal capacity).
- By comparison, two years ago (2014-15 fiscal capacity), the BEA made changes to definitions that led to large revisions to per capita income, and those revisions averaged \$761 in magnitude.

Department of Revenue's Revisions: Sale Tax Base

- The Tennessee Department of Revenue continually audits sales tax receipts, and this leads to small changes in its estimates of county sales tax bases, which were revised accordingly.
- These revisions were a lot smaller than the revisions in per capita income, averaging \$11 per capita (versus \$1,290 for per capita income) in magnitude.
- However, the revisions were significant (>1%) for two counties, Claiborne and Hardin.

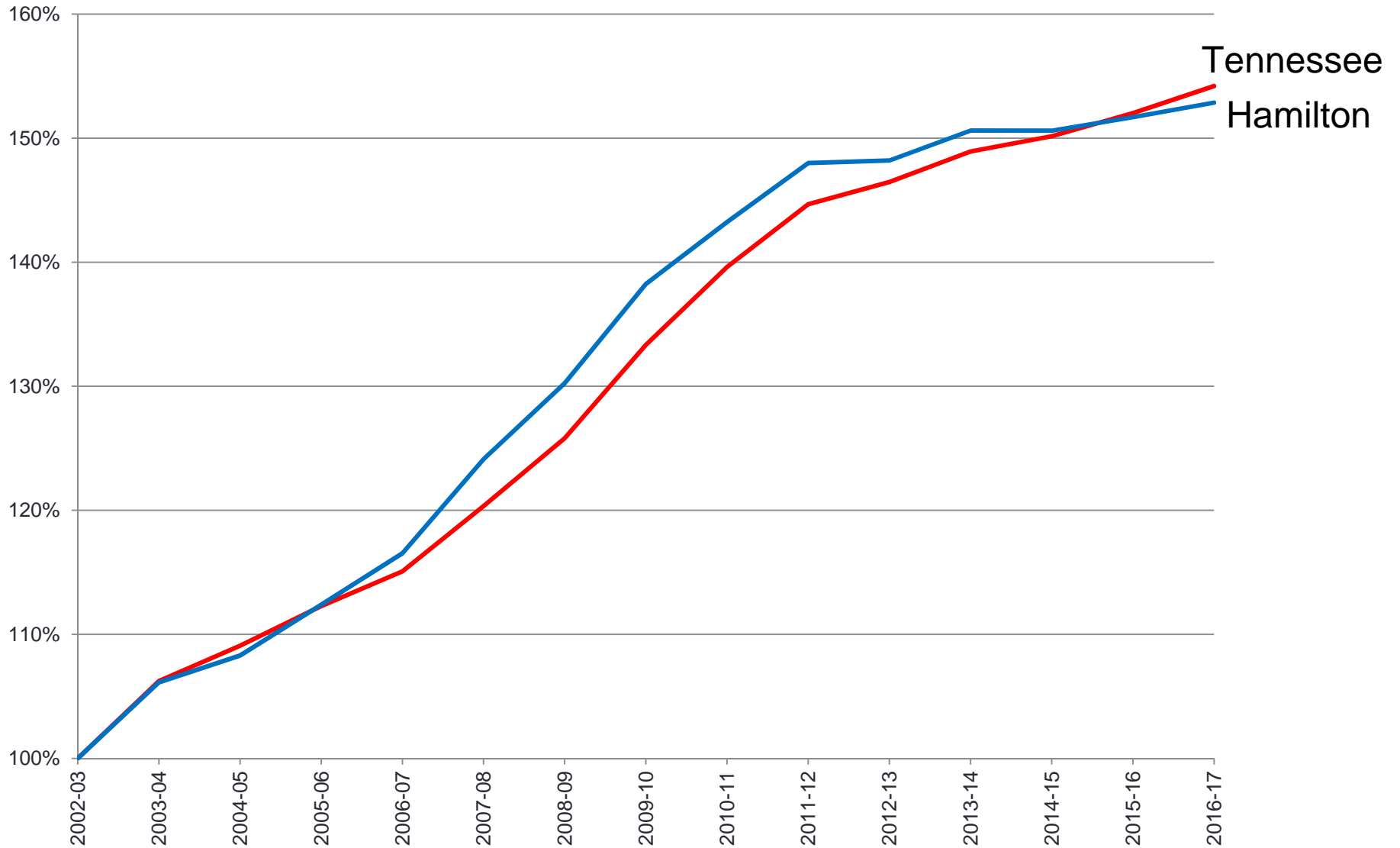
County Trends in Share of Statewide Fiscal Capacity

The change in a county's share of statewide fiscal capacity depends on its growth in fiscal capacity relative to the state's overall growth in fiscal capacity.

- A county whose fiscal capacity grows faster than the statewide total will increase its share and vice versa.
- Hamilton County's tax base has grown by about the same percentage as the statewide total over the last 15 years. The result is that Hamilton County's share of statewide fiscal capacity has remained about the same.

Combined Tax Base per Student (Sales and Property) as a Percentage of 2002-03 Combined Tax Base per Student

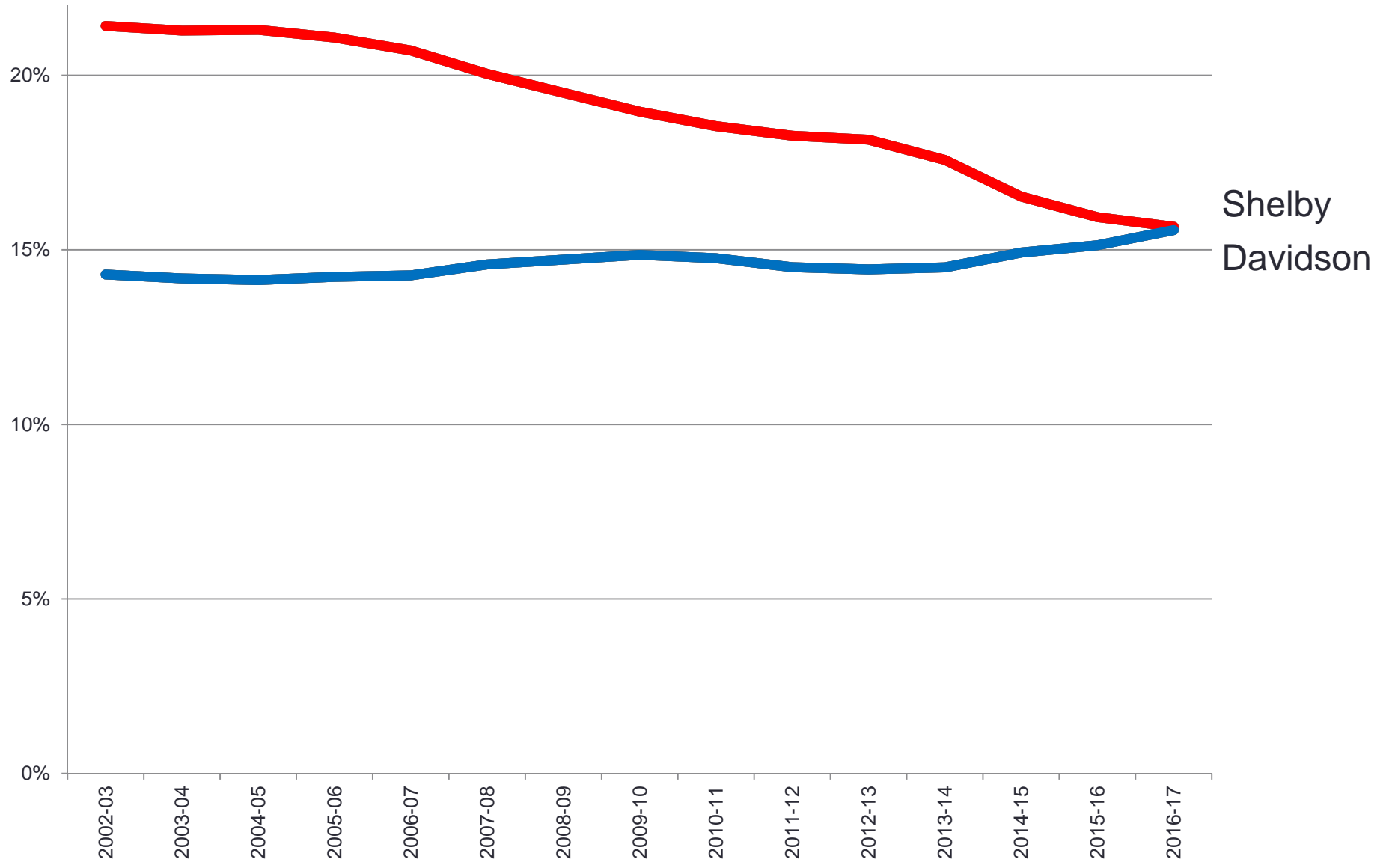
*2002-03 to 2016-17 Models**



*Fiscal capacity models use three-year average tax bases.

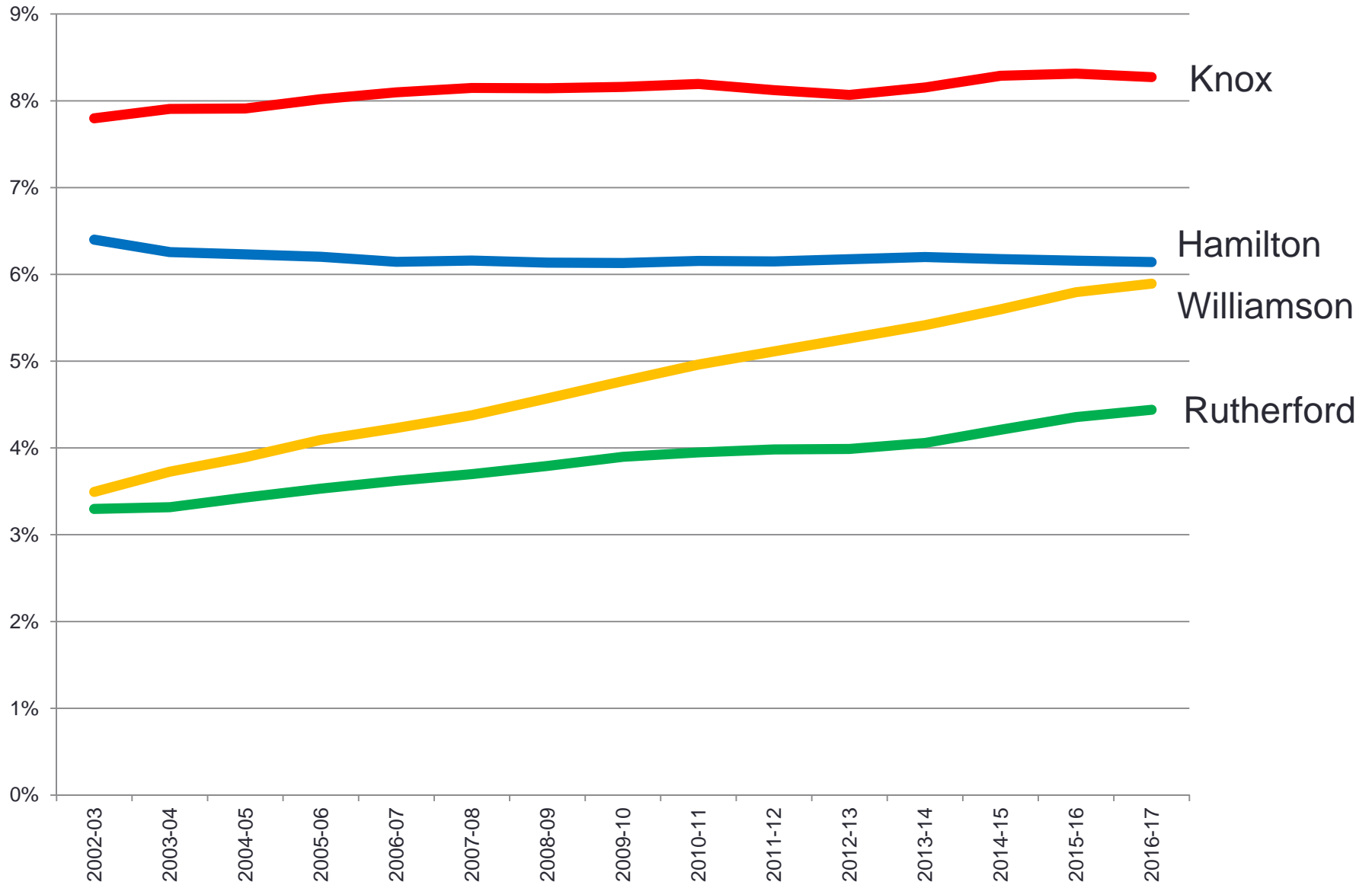
Percentage of Total Fiscal Capacity

2002-03 to 2016-17



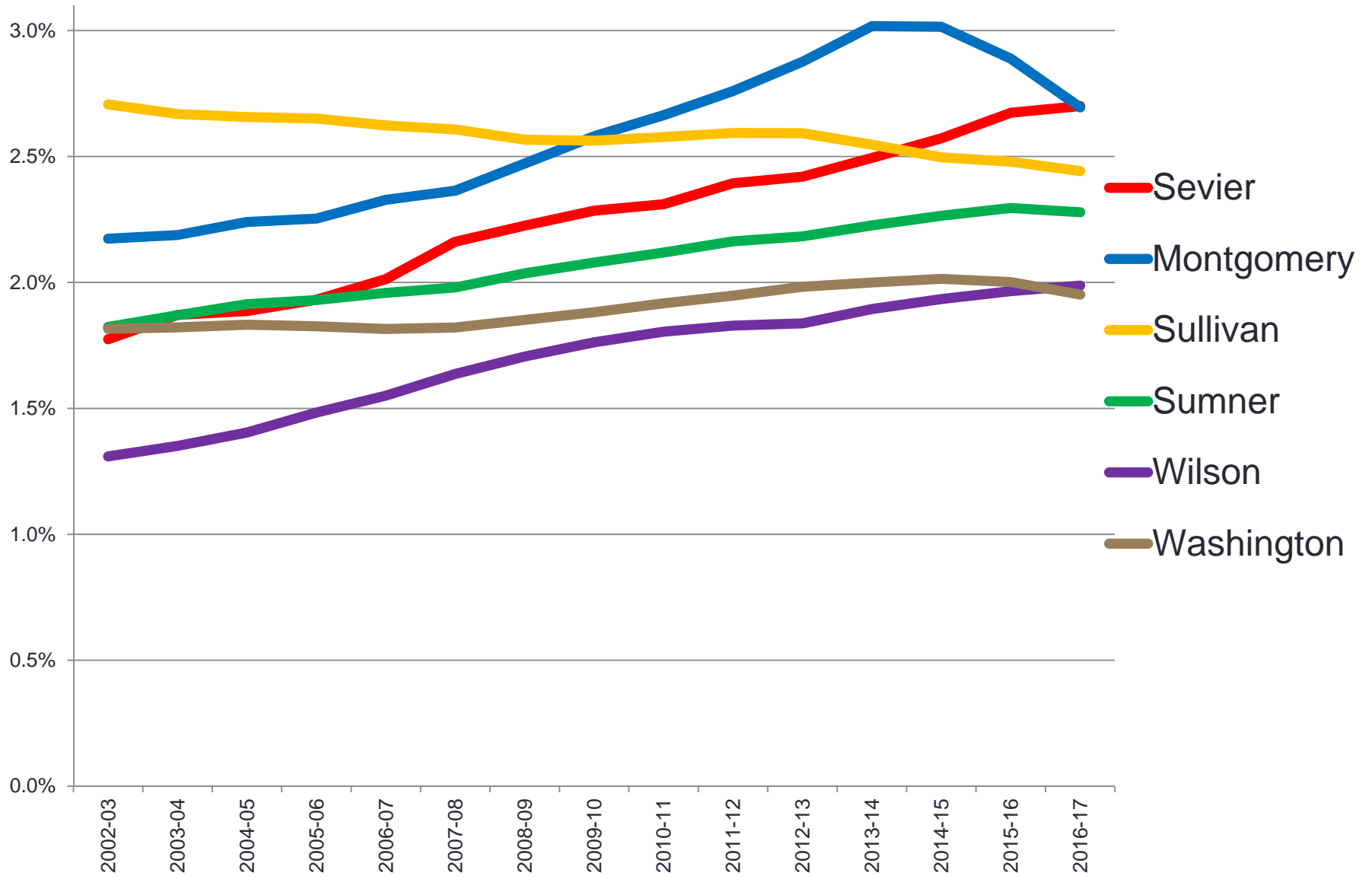
Percentage of Total Fiscal Capacity

2002-03 to 2016-17

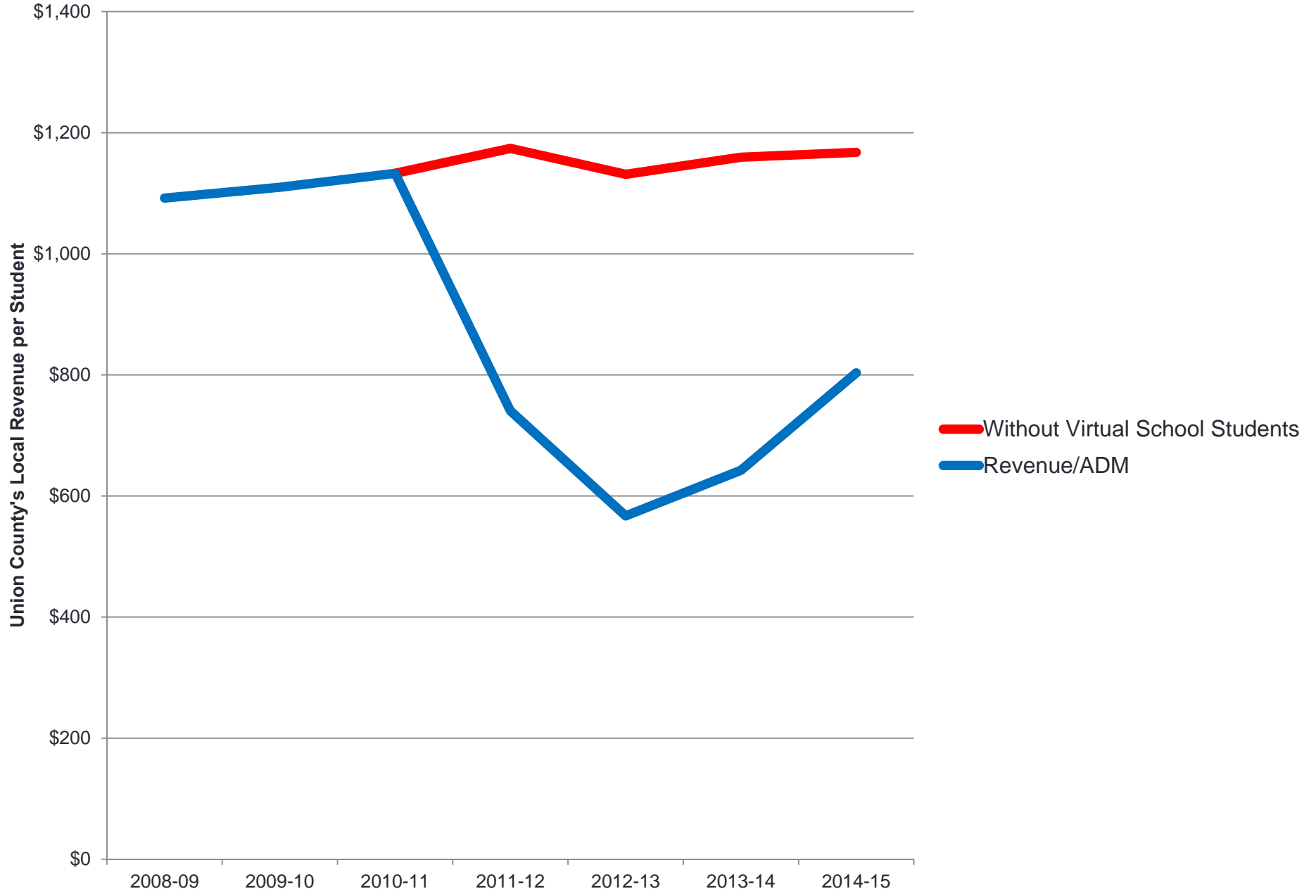


Percentage of Total Fiscal Capacity

2002-03 to 2016-17

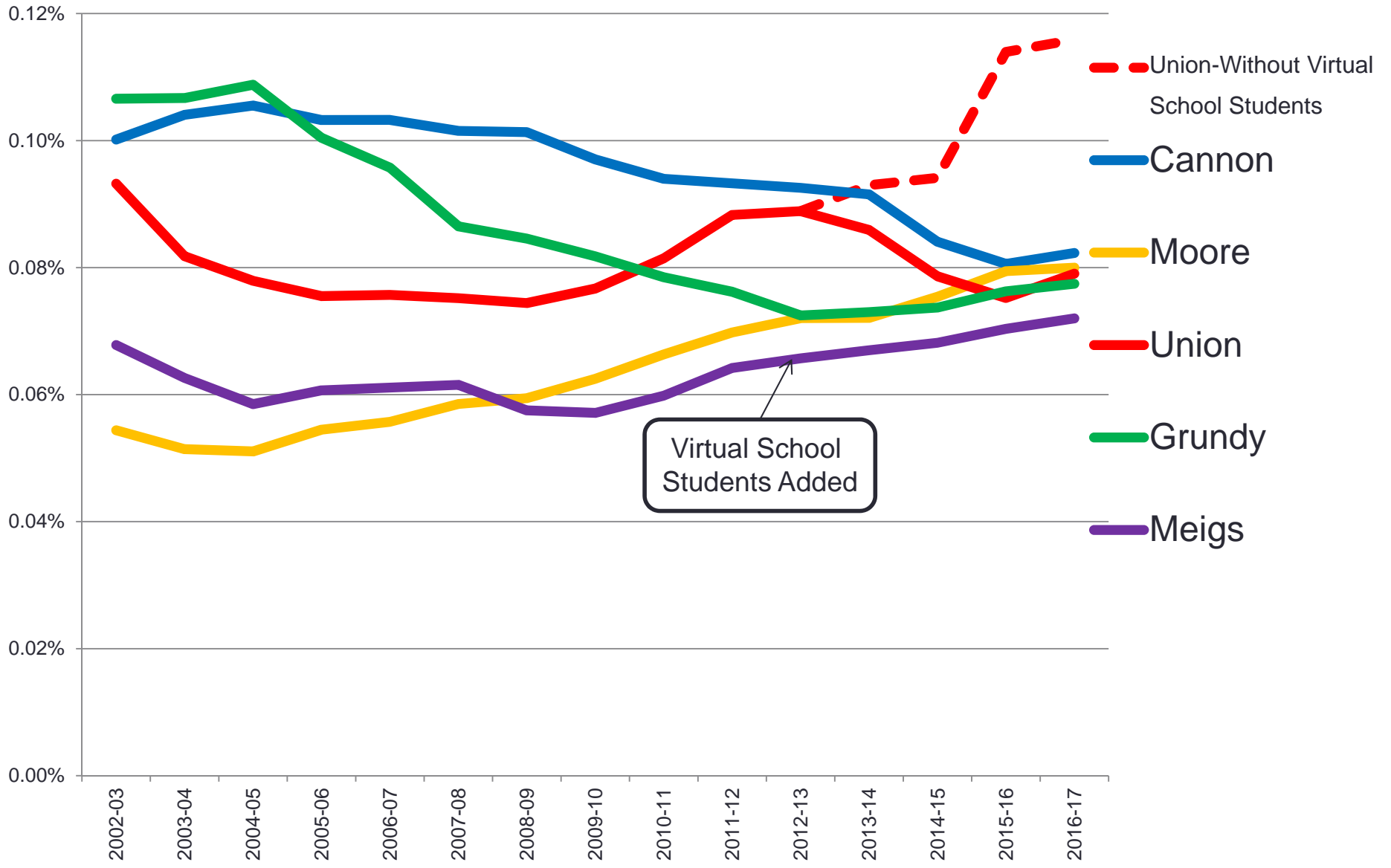


Union County's Local Revenue per Student



Percentage of Total Fiscal Capacity

2002-03 to 2016-17



As fiscal capacity for Union County decreases, the other 94 counties are responsible for a greater share of the BEP local match.

