

## How California's Schools Get Their Money

California's K-12 school districts get their funding from a number of state, local, and federal sources. The majority of districts' funds are designated for general purposes, while others are earmarked for specific programs. Some districts raise a majority of what they spend from local property tax revenues, while others receive most of their funds from the state.<sup>1</sup> Per pupil funding varies from district to district and the share of revenue schools receive from different sources has changed significantly over time. This *School Finance Facts* examines school district revenues and recent proposals to reform the education finance system.

### Where Do School Districts' Funds Come From?

California's schools received \$58.6 billion to conduct their day-to-day operations in 2006-07.<sup>2</sup> State funding accounted for more than six out of every 10 dollars (60.2 percent) received by schools statewide (Figure 1).<sup>3</sup> In addition, local sources accounted for somewhat less than one-third (29.0 percent) of school revenues, federal monies accounted for less than one out of ten dollars (9.2 percent), and 1.6 percent came from the state lottery. Local property taxes and fees accounted for nearly three-quarters (73.7 percent) of the funds districts raised from local sources. Other local revenue sources, such as parcel taxes, contributions, and gifts, accounted for slightly more than one-quarter (26.3 percent) of the amounts districts raised at the local level.

Nearly all state spending on schools comes from the state's General Fund. This is because the California Department of Education (CDE) provides most of the funds that schools receive from the state, and the General Fund accounts for nearly all state funding (99.8 percent) for the CDE.<sup>4</sup> This nearly total reliance on the General Fund contrasts with state funding for other programs such as the Department of Transportation, which receives less than one-third (30.5 percent) of its funding from the state's General Fund. Schools' dependence on the state's General Fund is important because education funding is vulnerable to cuts during the state's budget crises when gaps between General

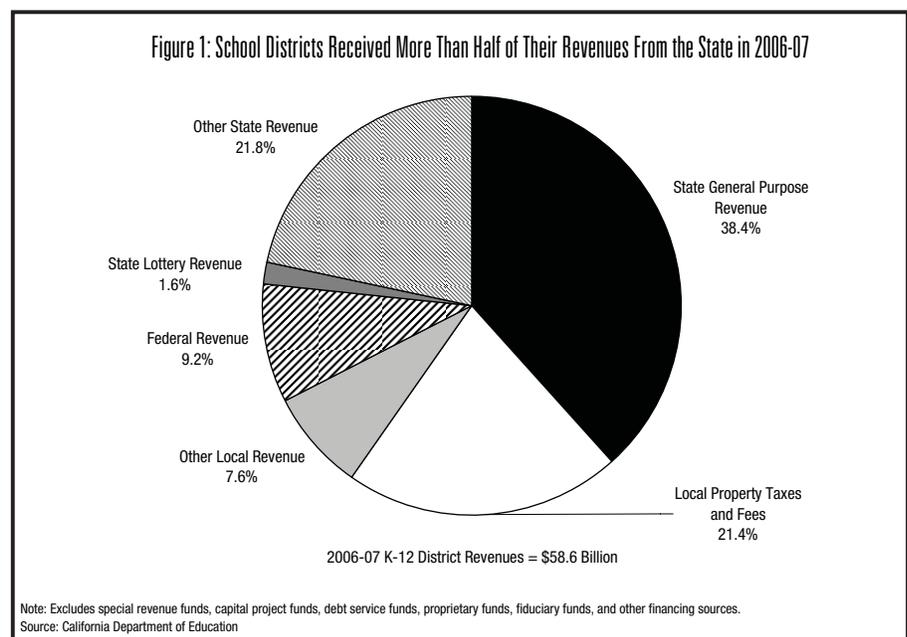
Fund revenues and expenditures must be bridged.

### How Do School Districts Receive Their Funds?

Schools receive two basic types of funds: dollars that are unrestricted and can be used for any purpose and funds that are restricted or "earmarked" for specific purposes. Unrestricted funds, which totaled \$38.5 billion in 2006-07, accounted for nearly two-thirds (65.7 percent) of school revenues statewide.<sup>5</sup> Approximately two-thirds of these unrestricted funds (67.7 percent) came

from the state and approximately one-third (31.6 percent) came from local sources.<sup>6</sup> Statewide, nine out of 10 dollars (89.7 percent) spent by school districts from their unrestricted revenues paid for salaries and benefits; 8.0 percent paid for services and other operating expenditures, such as electricity, heating, water, and insurance; and 2.3 percent paid for books and supplies.<sup>7</sup>

Revenues earmarked for specific purposes, which totaled \$20.1 billion in 2006-07, accounted for slightly more than one-third (34.3 percent) of schools' statewide revenues. Schools received half (50.5



percent) of all earmarked funds from the state, one-quarter (25.4 percent) from the federal government, and nearly one-quarter (24.1 percent) from local sources in 2006-07.<sup>8</sup> Earmarked revenues include funds designated for programs such as special education and professional development.

While federal funds accounted for fewer than one out of 10 dollars (9.2 percent) received by schools statewide in 2006-07, 95.0 percent of federal funds were earmarked for specific purposes. Furthermore, to receive some federal funds, districts must comply with federal regulations including those of the No Child Left Behind Act. In contrast, statewide, more than seven out of 10 dollars (72.0 percent) that schools received from the state were unrestricted in 2006-07.

### What Are Revenue Limit Funds?

Revenue limits provide the largest share of general purpose funding for local schools. In 2006-07, schools received \$35.1 billion as revenue limits, which accounted for more than half (59.8 percent) of schools' revenues and more than nine out of 10 (91.0 percent) of the unrestricted dollars schools received statewide.

The state implemented revenue limits in 1973-74 to address disparities in school funding. Prior to the establishment of revenue limits, schools were financed largely with property tax rates imposed by local school districts. Variations in the value of taxable property among districts resulted in significant disparities in per pupil property tax revenues. Disparities arose because districts with high property values could raise more money from the same property tax rate than could ones with lower property values. These disparities were particularly large prior to the passage of Proposition 13 of 1978, when properties were annually reassessed to full market value for tax purposes.<sup>9</sup>

SB 90 (Dills, Chapter 1406 of 1972), and subsequent legislation enacted in the wake of the 1971 California Supreme Court decision in *Serrano v. Priest*, addressed the court's directive to reduce school funding disparities.<sup>10</sup> The result was the establishment of a revenue limit funding formula that limited the amount of state and local revenue schools could receive for general purposes and constrained revenue growth in high-revenue school districts.<sup>11</sup> The formula used to calculate each

district's revenue limit included an annual inflation-adjustment based on a district's level of revenue. While the formula allowed for annual revenue increases for all districts, it restricted the revenue limit growth rate of high-revenue districts. Districts with lower revenues received larger increases in order to "level up" funding, while districts with high revenues received smaller adjustments in order to gradually "level down" funding.

In addition to a district's historical spending patterns, several other variables determine a district's revenue limit, including its type (elementary, high school, or unified) and size (small or large).

Despite the effort to equalize funding between high- and low-wealth school districts, significant disparities remain. For example, in 2006-07, the Palo Alto Unified School District received \$8,774 per student in revenue limit funding, which was approximately one-third more than the Alameda City Unified School District received (\$5,648 per student).

Funding for revenue limits come from two sources: local property taxes and the state. The amount of revenue limit funding a school district receives from each source depends on the amount of money the district receives from local property tax revenues. If a district's local property tax

Figure 2: Palo Alto Unified Received Nearly All Revenue Limit Funds From Local Property Taxes in 2006-07

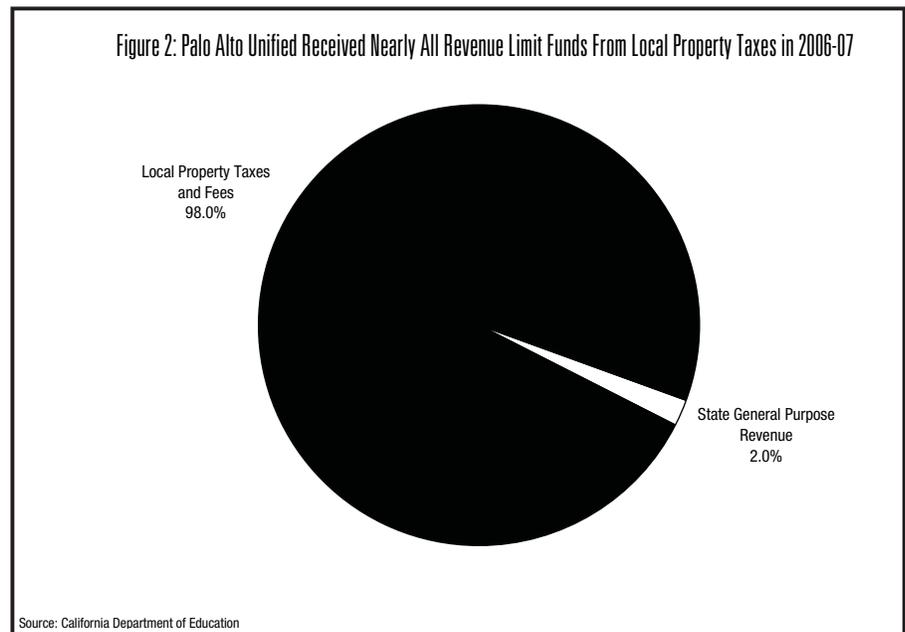


Figure 3: Alameda City Unified Received Nearly Two-Thirds of Revenue Limit Funds From the State in 2006-07

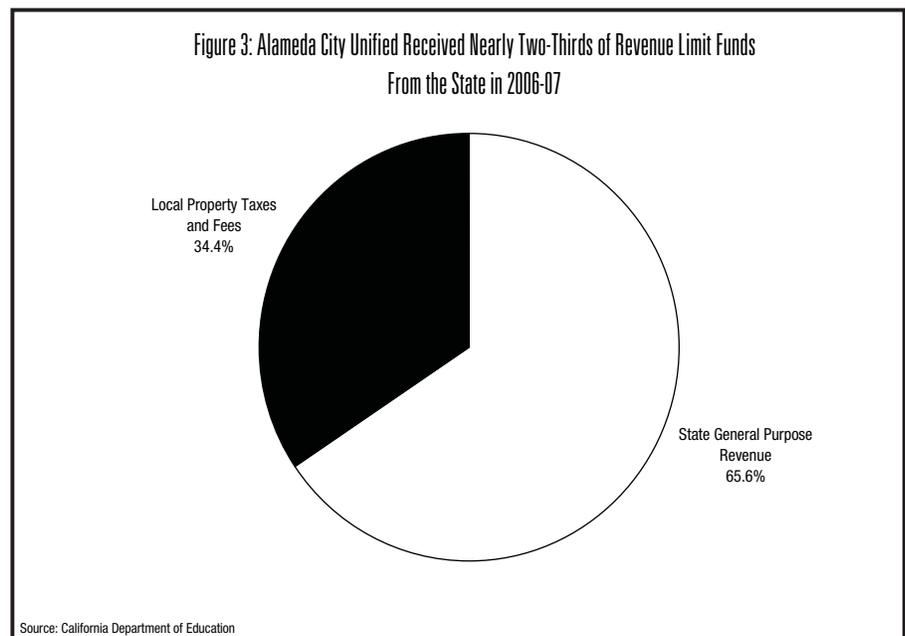
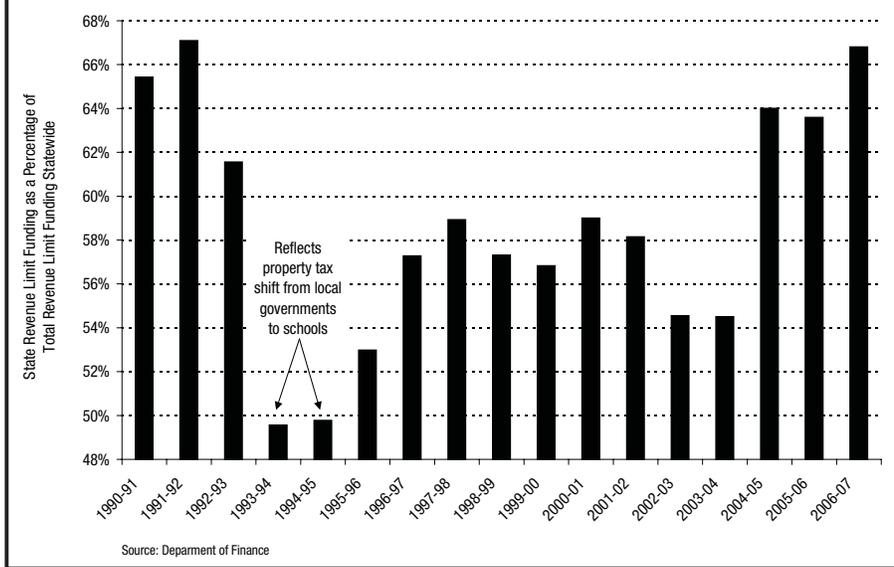


Figure 4: The Share of Revenue Limit Funds Provided by the State Fluctuates



revenues are less than its revenue limit, the state makes up the difference. Some districts raise a larger share of revenue limit funds from local property taxes than others. For example, in 2006-07, the Palo Alto Unified School District raised nearly all (98.0 percent) of its revenue limit funds from local property taxes (Figure 2). In contrast, the Alameda City Unified School District received approximately two-thirds (65.6 percent) of its revenue limit funds from the state in the same year (Figure 3).<sup>12</sup> While Palo Alto and Alameda City are both unified districts of similar size, the amount and share of revenue limit funding they receive from the state varies as it does for other districts.

School districts that raise all of their revenue limit funds from property tax revenues are known as “basic aid” districts and tend to be located in high property value, high-wealth districts. Basic aid districts are allowed to keep property tax revenues in excess of their respective revenue limits and also receive other state funds for specific programs. In 2007-08, 98 of the state’s 973 school districts (10.1 percent) were basic aid districts.

### The State’s Share of Revenue Limit Funding Fluctuates

The amount the state contributes to districts’ revenue limit funds is determined by the amount of property taxes local districts receive. In 1990-91, nearly two-thirds (65.4 percent) of school revenue limit funds came from the state (Figure

4). In contrast, the state provided less than half of districts’ revenue limit funds in 1993-94 and 1994-95. The shift was largely due to the reallocation of local property tax revenues from cities, counties, and special districts to schools. Since 2004-05, the state has contributed more than six out of every 10 dollars of districts’ revenue limits. In 2006-07, the state’s share of revenue limit funding rose to two-thirds (66.8 percent) of the revenue limit funds schools received statewide. To the extent property tax revenue growth slows or even declines, the state’s share of funding for revenue limits will rise. This, in turn, will increase demand on scarce state budget resources at a time when the state is experiencing substantial shortfalls.

### More Than One-Third of School Dollars Are Earmarked

Funds earmarked for specific school programs such as class size reduction, special education, and professional development accounted for more than one-third (34.3 percent) of district revenues in 2006-07.<sup>13</sup> The state restricts districts’ use of funds for various reasons, which include supporting policy objectives, such as reducing class sizes, and ensuring that funding is available for specific purposes, such as the purchase of instructional materials.

Earmarked funds do not always fully support the costs of the program they are designed to support. In this case, districts may have to pay for a portion of program costs with general purpose funds. For

example, districts are required to offer transportation services by law, but do not necessarily receive sufficient funds to cover the full cost of services.

Recent policy debates have focused on the balance between schools’ discretionary and earmarked funding – most of which is referred to as categorical aid. Over the past 30 years, categorical aid has increased nearly threefold – from approximately one out of ten dollars (10.3 percent) received by schools statewide in 1976-77 to nearly one-third (29.9 percent) of statewide revenues in 2006-07.<sup>14</sup> This increase has led to several proposals to change how schools receive categorical aid. Some questions raised by these proposals include whether to change the formulas used to determine levels of categorical aid and whether to create “block grants” to allow districts to spend earmarked funds for a larger array of purposes.

### What Revenues Do Schools Raise From Local Sources?

In 2006-07, districts received \$12.5 billion from local property tax collections, slightly more than one out of every five dollars (21.4 percent) received by schools statewide. In addition to local property taxes, schools raise other local revenues from sources that include parcel taxes and other taxes and fees imposed to support programs and facilities, equipment and food service sales, the lease or rental of school buildings, interest on school fund deposits, fees for services, and gifts.<sup>15</sup> While local revenues other than the property tax accounted for 7.6 percent (\$4.5 billion) of school funds statewide in 2006-07, some districts raise more funds from these sources than do others. This can lead to funding disparities among school districts. For example, the Palo Alto Unified School District raised \$2,734 per student in other local revenue in 2006-07, more than two and one-half times the amount raised by the Alameda City Unified School District (\$1,046 per student).<sup>16</sup>

One source of this disparity may be the portion of other local revenue that includes voluntary contributions and gifts. Schools report that they raised more than one out of five dollars (22.4 percent) of other local revenue from these sources statewide in 2006-07.<sup>17</sup> However, comprehensive data on private contributions to local schools are not available because schools are not required to separate contributions from organizations such as Parent

## School Revenues and the Proposition 98 Guarantee

Proposition 98, passed by California voters in 1988, constitutionally guarantees a minimum level of funding for K-12 education, community colleges, and related child development, mental health, and developmental service programs.<sup>18</sup>

Proposition 98 states that K-14 education shall receive the greater of a fixed percentage of state General Fund revenues or the amount they received in the prior year, adjusted for enrollment and inflation.<sup>19</sup>

Revenue limit funds and most state categorical aid received by schools count toward the Proposition 98 minimum funding level. School revenues that do not count toward the Proposition 98 guarantee include federal revenue, state lottery revenue, property tax revenues in excess of a basic aid districts' revenue limit, and other local revenues, such as parcel tax revenues.

Proponents intended Proposition 98 to guarantee a minimum amount of funding for California's schools. However, Proposition 98's minimum funding guarantee has often been a ceiling, as well as a floor. Furthermore, the factors used to calculate the Proposition 98 guarantee are not determined until late in the state's budget process. As a result, the minimum funding level guaranteed by Proposition 98 can change during the fiscal year. The state's frequent and lengthy budget stalemates often require districts to approve a budget before they know how much money they will receive from the state, which makes schools' annual budgeting process challenging.

Teacher Associations and local education foundations – tax-exempt organizations that raise funds to support schools – from other school revenues such as library fines.<sup>20</sup> Moreover, most observers believe schools do not report all contributions and gifts, further masking funding disparities. Despite these accounting issues, districts in high-income areas receive a disproportionate amount of these funds. For example, the Palo Alto Unified School District raised \$672 per student in 2006-07, more than five times the amount raised by the Alameda City Unified School District (\$115 per student).<sup>21</sup>

Parcel taxes may be another reason other local revenue varies among school districts. School districts can impose parcel taxes by a two-thirds vote of local voters. Typically, parcel tax revenues are used to reduce class sizes or expand course offerings. In recent years, districts have passed parcel tax measures to support a variety of purposes including class size reduction, teacher retention, and instructional materials. While parcel taxes can help schools fund programs, relatively few districts pass parcel tax measures and those that have tend to serve affluent communities.<sup>22</sup> In 2006-07, one out of 10 districts (10.3 percent) imposed local parcel taxes.<sup>23</sup> Moreover, between 1983 and 2006, fewer than one out of five districts placed parcel tax measures on local ballots and voters approved just slightly more than half (51.0 percent) of the measures placed before them.<sup>24</sup> Nearly all parcel tax elections occurred in higher-income districts, suggesting that higher-income districts are more likely to receive parcel tax revenues.<sup>25</sup> As a result, while parcel taxes provide schools the ability to raise local revenue, they also can lead to greater funding disparities among districts.

### How Would Proposals To Change the Education Finance System Affect School Revenues?

Studies released in 2007 as part of the foundation-supported "Getting Down to Facts" (GDTF) series found that California's school finance system is "extraordinarily complex and has no coherent conceptual basis."<sup>26</sup> Proposals to reform California's education finance system address GDTF's findings and would streamline how districts raise revenues.

The Governor's Committee on Education Excellence (GCEE), appointed by the Governor in April 2005 to recommend steps to improve public schools, proposes transitioning to a "student-centered" funding system. This system would consolidate most district revenue into a per pupil base grant, which would vary depending upon the grade level of each student, and a targeted grant for economically disadvantaged students and English learners.<sup>27</sup> The GCEE recommends that all districts receive at least the same amount as they received prior to transitioning to the new funding formula. The proposal also would reduce the overall number of programs supported by earmarked funds. The GCEE's recommendations would provide school districts increased flexibility in the allocation and use of school revenue. However, it is unclear whether GCEE's proposal to use an improved accountability system and a school-level accounting system would ensure targeted funding gets to the students it is intended to serve.

A proposal made by the Legislative Analyst's Office (LAO) in 2008 would modify the education finance system by consolidating 43 individual K-12 education funding streams into four block grants: a base grant, a special education grant, an opportunity to learn grant, and an instructional improvement grant.<sup>28</sup> These grants consolidate funding sources so that:

- The base grant would provide funding for ordinary classroom operations;
- The special education grant would provide additional flexibility in the use of special education funds;
- The opportunity to learn grant would provide funding for compensatory instructional services for disadvantaged students and other types of services that promote learning in schools; and
- The instructional improvement grant would provide funding for staff development and instructional services, such as arts and technology programs.

While the block grants proposed by the LAO would allow schools greater flexibility in how funds are used, they would not change the distribution or levels of funding currently provided.<sup>29</sup> In contrast, the GCEE proposal recognizes a need to provide additional resources to districts with large

shares of English learners and students from low-income families.

## Conclusion

Consolidating district revenue likely would reduce the complexity of the state's financing system as well as allow schools greater flexibility in how their funds are used. While these are desirable goals, policymakers should structure changes to the education finance system so that schools' revenues reach the students for whom they are intended. This is especially true in light of recent research that suggests additional funding for students from low-income families and English learners will be required to improve their academic performance. Despite the current period of constrained resources, policymakers should consider potential revenue sources to boost education funding for students from low-income families and English learners if they wish to address the persistent achievement gap they consistently criticize.

## END NOTES

<sup>1</sup> Although state and local funds are provided to K-12 school districts, this *School Finance Facts* uses the terms "schools" and "districts" interchangeably.

<sup>2</sup> 2006-07 is the most recent year for which school revenue data are available. The California Department of Education (CDE) provides detailed revenue data at the district level; however, it does not provide the same information at the school site level. As a result, it is difficult to assess how revenue varies among school sites within a school district or to compare school site revenues for different districts.

<sup>3</sup> CBP analysis of CDE data. The analysis in this *School Finance Facts* accounts for the ordinary operations of local education agencies, county offices of education, and seven charter schools that report independently of their chartering school district or the county office of education. This analysis excludes special revenue funds; capital project funds; debt service funds, which include bond redemptions and interest; proprietary funds, which include funds such as cafeteria and warehouse funds; fiduciary funds, which include pension trust funds and retiree benefit funds; and other financing sources, which include interfund transfers and emergency apportionments.

<sup>4</sup> CBP analysis of Legislative Analyst's Office (LAO) data.

<sup>5</sup> CBP analysis of CDE data.

<sup>6</sup> Unrestricted state funds include a share of state lottery revenues.

<sup>7</sup> CBP analysis of CDE data. Excludes capital outlay, other outgo, such as debt service, and other financing uses, such as interfund transfers.

<sup>8</sup> CBP analysis of CDE data. Earmarked state funds include state lottery revenues that must be spent on instructional materials.

<sup>9</sup> Paul M. Goldfinger and Jannelle Kubinec, *Revenues and Revenue Limits: A Guide to School Finance in California, 2008 ed.* (Sacramento, CA: School Services of California, Inc., 2008), pp. 3-4.

<sup>10</sup> Paul M. Goldfinger and Jannelle Kubinec, *Revenues and Revenue Limits: A Guide to School Finance in California, 2008 ed.* (Sacramento, CA: School Services of California, Inc., 2008), p. 5.

<sup>11</sup> Revenue limit funds are composed of two main parts: base revenue limits and "add-on" programs. The base revenue limit accounts for the largest share of revenue limit funds and pays for basic educational costs. "Add-on" programs fund specific programs such as continuation schools, minimum teacher salary incentive, and meals for needy pupils.

<sup>12</sup> CBP analysis of CDE data. These districts are of comparable size and are both located in the San Francisco Bay Area. In 2006-07, the average daily attendance of Palo Alto Unified was 10.3 percent larger than that of Alameda City Unified.

<sup>13</sup> CBP analysis of CDE data.

<sup>14</sup> Governor's Committee on Education Excellence, *Technical Report: Students First – Renewing Hope for California's Future* (November 2007), Priority 2: Finance 5-2.

<sup>15</sup> Other local revenue is separate from revenue limit funds and categorical aid. Interagency transfers, which include transfers of apportionments for Special Education and Regional Occupational Center/Programs from one district to another, account for the largest share of other local revenue. The CDE's statewide financial data "includes interagency transactions both when they appear as an expenditure in one district and as a revenue in another. This results in a double counting that slightly distorts revenues and expenditures. Excluding these interagency transactions would result in a reduction of approximately 2% (3% in 2006-07) for statewide district totals."

<sup>16</sup> CBP analysis of CDE data.

<sup>17</sup> CBP analysis of CDE data.

<sup>18</sup> For an explanation of the Proposition 98 guarantee, see California Budget Project, *School Finance in California and the Proposition 98 Guarantee* (April 2006).

<sup>19</sup> The Proposition 98 guarantee establishes a required funding level for programs falling under the guarantee as a whole. It does not create an "entitlement" to funds for any particular program. The Legislature has the authority to allocate funding to individual programs through the budget. The Legislature also can suspend Proposition 98 for a single year by a two-thirds vote.

<sup>20</sup> The CDE defines "all other local revenue" as one of the sources of other local revenue. Examples of all other local revenue include "library fines, contributions, gifts, and reimbursement for practice teaching." The CDE does not require districts to account for the amount of revenue generated by individual revenue sources within all other local revenue. In-kind contributions of services, such as parents serving as classroom aides, typically are not accounted for by schools and thus are not reflected in other local revenue.

<sup>21</sup> CBP analysis of CDE data.

<sup>22</sup> Thomas Timar, *How California Funds K-12 Education* (Institute for Research on Education Policy and Practice: September 2006), p. 27.

<sup>23</sup> CBP analysis of CDE data.

<sup>24</sup> EdSource, *Parcel Tax Election Trends*, downloaded from [http://www.edsource.org/iss\\_fin\\_sys\\_parceltax.html](http://www.edsource.org/iss_fin_sys_parceltax.html) on January 16, 2009.

<sup>25</sup> Approximately nine out of 10 parcel tax elections took place in higher-income districts, meaning those that have fewer low-income students than the average for the state as a whole.

<sup>26</sup> Susanna Loeb, Anthony Bryk, and Eric Hanushek, *Getting Down to Facts: School Finance and Governance in California* (Institute for Research on Education Policy and Practice: March 2007), p. 40.

<sup>27</sup> Governor's Committee on Education Excellence, *Technical Report: Students First – Renewing Hope for California's Future* (November 2007), Priority 2: Finance 5-22. The GCEE proposal maintains separate funding for Special Education.

<sup>28</sup> Legislative Analyst's Office, *Analysis of the 2008-09 Budget* (February 2008), pp. E-65 to E-66.

<sup>29</sup> Legislative Analyst's Office, *Analysis of the 2008-09 Budget* (February 2008), p. E-66.

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