To: Interested Parties
From: Chad Marturano, Vice President and CFO
Kate Watkins, Economic Consultant
Re: School Finance Impact of SB24-233, Initiative #50, and Initiative #108
Date: **DRAFT** August 2024

School Finance Impact Estimates

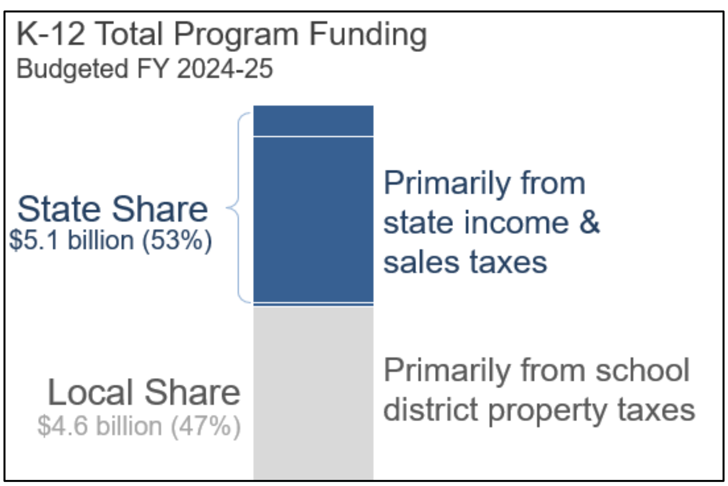
The following summarizes estimates of the impact of SB24-233, Initiative #50, and Initiative #108 on the state share of school finance funding and state budget flexibility. This analysis does not include the impact these measure would have on the state budget resulting from requirements to back fill revenue reductions that would be experienced by other non-school district local governments and special districts.

Relevant Background

Colorado's state government and school districts share funding responsibilities for K-12 education. Each year, the level at which each school district is funded is determined by the state legislature with certain constitutional parameters. Under the constitutional provision known as Amendment 23, a certain level of K-12 total program[1] funding is required each year, and this amount grows by inflation plus enrollment growth. The legislature has discretion to fund K-12 at a level that is in excess of the Amendment 23 requirement. Each local school district's property tax revenue is applied toward covering the funding level approved by the state. The remaining cost, not covered by each local school districts' property tax, is covered by the state. The state's share of K-12 funding for education primarily comes from state income and sales tax revenue, the vast majority of which is funded from the state General Fund.

When property tax revenue is reduced, either because of economic activity or a policy change, the state share obligation to fund school districts grows. An illustration of K-12 total program funding from state share and local share in FY 2024-25 is below.

<u>Figure One:</u>
State Share and Local Share



[1] A majority of K-12 education funding falls under total program funding. However, a smaller share comes from discretionary state funds and mill levy override property tax revenue to school districts.

How are property taxes calculated?

Property taxes in Colorado are calculated based on the following formula, where assessment rates determine the share of the actual (e.g., market) value of property that is taxes:

Actual Value × Assessment Rate = Assessed Value

Assessed Value × Local Mill Levy = Taxes Owed

Based on this formula, the following provides an example of the taxes owed:[2]

$500,000 Home × 7.15% = $35,750 Assessed Value

$35,750 × 72 Mills/1000 = $2,574 Owed

Comparing the Property Tax Structures Across Measures

Table 1 below compares the property tax structures under SB24-233, Initiative #50, and Initiative #108. Initiative #108 would result in larger assessment rate reductions than those under SB24-233. Initiative #50 does not impact assessment rates but does limit year-over-year growth in statewide property tax revenue across all local governments to 4% annually.

Table One:
School Finance Property Tax Structures by Measure[3]

	Tax Year	**Base Case** Pre-SB24-233	**SB24-233**	**#108**	**#50**
Residential Assessment Rates	2024	6.8% multifamily; 7.06% all other	6.7% and $55,000 subtraction	Base case	Beginning in 2025, 4.0% annual **growth limit** for statewide property tax revenue
	2025+	7.15%	7.15%*	5.7%	
Non-residential Assessment Rates Excluding oil & gas	2024	26.4% ag & renewable 29% all other	26.4% ag & renewable 27.9% all other	Base case	
	2025	29%	27% ag & renewable, commercial 29% all other	24%	
	2026+	29%	25% ag & renewable, commercial 29% all other	24%	

*If the local share exceeds 60% of total program funding, residential assessment rates decline.

[2] This example assumes the 2022 residential assessment rate and statewide average mills from 2022. Lower rates are set under current law in future years and mill levies vary by location.
[3] Residential assessment rates under SB24-233 are only shown for school district total program revenue in Table 1. Residential assessment rates are lower under the bill for other local governments.

School Finance Impact Estimates

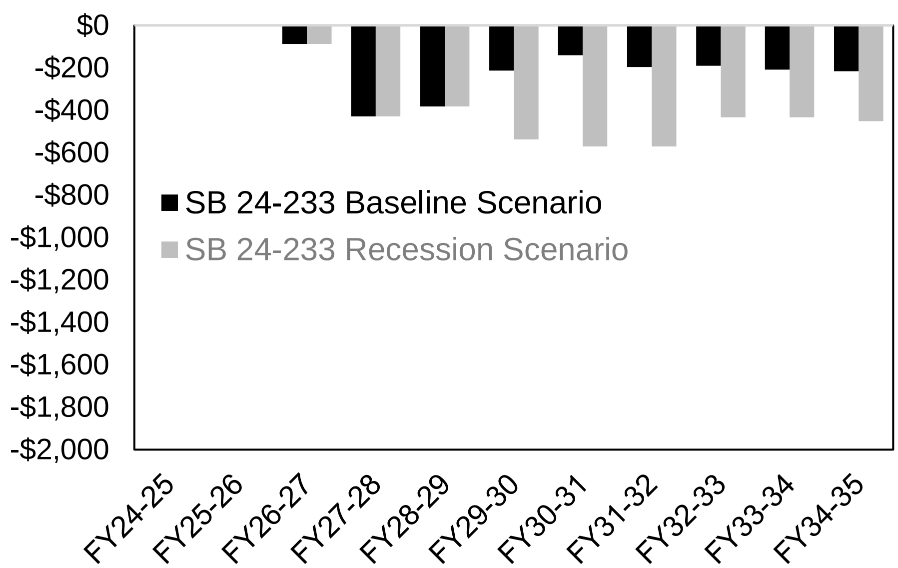
In the following section, estimated impacts on the state's General Fund flexibility are summarized, based on no changes to the School Finance Act such as reinstatement of the budget stabilization factor. These estimates are as follows:

- Figure Two: SB24-233
- Figure Three: Initiative #50
- Figure Four: Initiative #108
- Figure Five Combination of Initiatives #50 and #108

Impacts are shown for a baseline economic scenario that assumes continued revenue growth and a recessionary scenario that assumes -2% decline in property tax revenue in tax year 2029 and stronger growth in subsequent years. Model assumptions are detailed in Appendix A.

The reduction in property tax revenue under these three measures would result in an increase in the state share of required funding for K-12. Figures 1 through 4 illustrate how much additional state General Fund funding would be required for K-12, which come at the cost of funding for other state programs. Alternatively, to maintain funding for other state programs, the General Assembly may reimplement the Budget Stabilization Factor, thereby reducing the amount of funding for K-12 education. Of course, a combination of cuts to other programs and reimplementation of the Budget Stabilization Factor could also occur.

<u>Figure Two:</u>
Change in General Fund Flexibility under SB24-233
Dollars in Millions

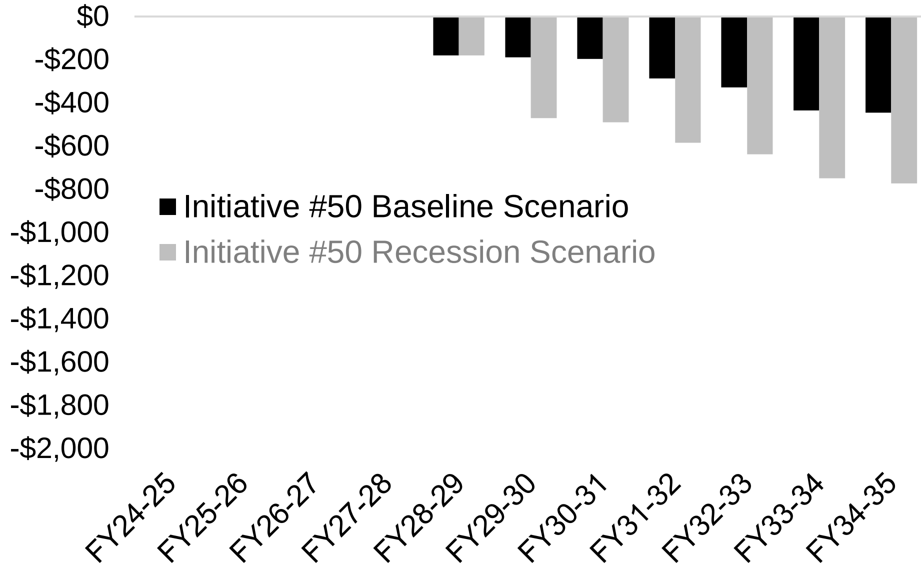


Impact Summary (in millions)	Annual Impact Range	Cumulative thru FY 2034-35
Baseline Growth	$87 to $429	$2,062
Recession	$87 to $571	$3,893

<u>Figure Three:</u>

Change in General Fund Flexibility under Initiative #50

Dollars in Millions

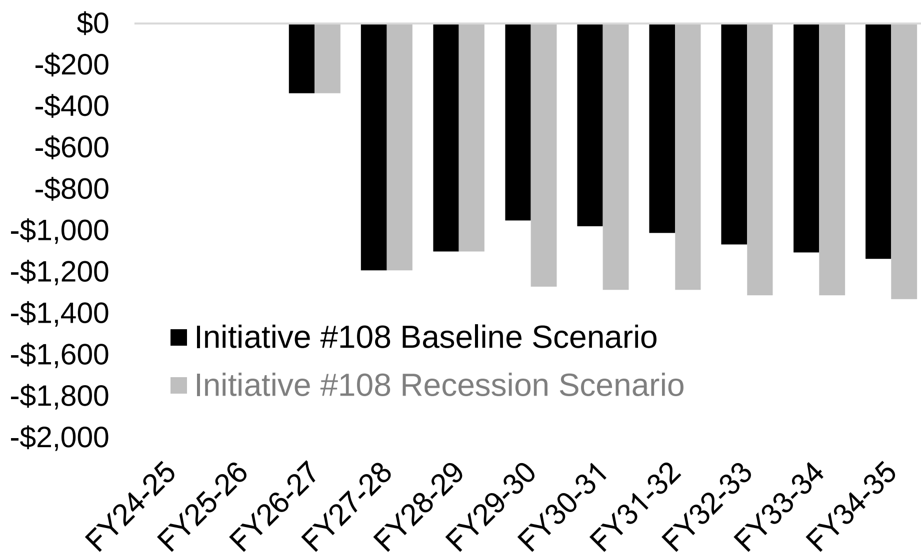


Impact Summary (in millions)	Annual Impact Range	Cumulative thru FY 2034-35
Baseline Growth	$181 to $446	$2,061
Recession	$181 to $772	$3,883

<u>Figure Four:</u>

Change in General Fund Flexibility under Initiative #108

Dollars in Millions



Impact Summary (in millions)	Annual Impact Range	Cumulative thru FY 2034-35
Baseline Growth	$336 to $1,192	$8,880
Recession	$336 to $1,330	$10,428

Figure Five:
Change in General Fund Flexibility under Initiative #50 and #108
Dollars in Millions

Impact Summary (in millions)	Annual Impact Range	Cumulative thru FY 2034-35
Baseline Growth	$336 to $1,497	$10,552
Recession	$336 to $1,759	$12,032

Ratchet-down effect of Initiative #50. Notably, Initiative #50 results in a ratchet-down effect when property revenue declines or grows at a slower pace than 4%, where allowable revenue permanently shifts lower and grows from that lower base. Revenue cannot return to trend or recoup revenue losses.

Initiative #108 Local Government Backfill Requirement

On July 29, 2024, LCS published a 2nd draft analysis for Initiative #108. In this 2nd Draft, LCS stated that #108 would result in a $2.4 billion reduction in statewide property tax revenue relative to current law in 2025. Of this $2.4 billion, up to an estimated $1.7 billion would have to be backfilled with state revenues to cover the impact Initiatve #108 would have on local government budgets in FY 2025-26. This $1.7 billion backfill estimate includes $630 million state backfill for K-12 education funding to offset the reduction in the local share that would result from the passage of Initiative #108.[4]

[4] Legislative Council Staff 2nd Draft Fiscal Summary for Initiative #108. Available at: https://leg.colorado.gov/sites/default/files/initiative%2520referendum_2023-2024%20108v2.pdf

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Office of State Planning and Budgeting Presentation: Impact to State's Budget

The Office of State Planning and Budgeting (OSPB) developed a presentation dated June 14, 2024[5], which illustrated some of the potential "Targeted Cuts" of the passage of Initiative 108 based on the LCS January 2024 Preliminary Fiscal Impact. OSPB was clear that these scenarios show ***"what the impact could be of 108 …[and] are not decisions by Administration, but are to show potential size and type of impacts on the budget."***

These potential Targeted Cuts include the following areas:

- Sweep Local Severance Funding to Backfill
- Adjust HUTF Revenue to free up funds under the TABOR cap
- Reduce Higher Education
- Reinstitute Budget Stabilization Factor (K-12)
- Provider rate cuts
- All other

Budget impacts will ultimately vary depending on budget writers' and policymakers' decisions, but if assuming similar targeted cuts from OSPB's June 2024 presentation, higher education could experience cuts.

On the following page, Table Two identifies possible amounts with estimated impacts to higher education's state funding that could range between -$160 million (10 percent cut) and -$450 million (27 percent cut). Assuming the University of Colorado's (CU) current share of the state's funding for higher education, CU's portion of this reduction would range between a $43 million cut and a $120 million cut. If this were offset by tuition, Colorado resident tuition rates would need to increase approximately 7 percent and 21 percent, respectively to generate enough revenue to backfill the state funding cut to the university. Of course, funding cuts of this magnitude at CU would likely be addressed through a combination of CU budget cuts and tuition increases.

[5] OSPB Presentation on the Budget Impacts of SB 24-233 and the Potential impact on Initiative 108 and Initiative 50, Mark Ferrandino – Director. June 14, 2024
https://leg.colorado.gov/sites/default/files/images/ospb_presentation.pdf

Table Two:

Draft Estimates Using OSPB June 2024 Materials Potential Targeted Cuts	7-29-24 LCS 2nd Draft			
	High Range Estimate <1>		Low Range Estimate <2>	
	$ Change	% Change	$ Change	% Change
Sweep Local Severance Funding to Backfill	(100,000,000)	-100%	(50,000,000)	-50%
Adjust HUTF Revenue to free up funds under the TABOR cap	(450,000,000)	-100%	(160,000,000)	-36%
Reduce Higher Education	(450,000,000)	-27%	(160,000,000)	-10%
Reinstitute Budget Stabilization Factor	(300,000,000)	-6%	(105,000,000)	-2%
Provider rate cuts	(300,000,000)	-6%	(105,000,000)	-2%
All other	(100,000,000)	-2%	(50,000,000)	-1%
Total	(1,700,000,000)		(630,000,000)	

<1> Lowered June 2024 OSPB Targeted Cuts proportionally between "Reduce Higher Education" and "Reinstitute Budget Stabilization Factor".

<2> Lowered "High Range Estimate <1>" roughly proportional across all categories.

Appendix A: School Finance Model Assumptions

School finance impact estimates are based on a detailed model developed and maintained by the CU System's budget and finance office that accounts for the many dynamics impacting K-12 revenue and expenditures.

The model assumes current law, and major 2024 K-12 legislation including SB24-188, HB24-1207, and HB24-1448. The model also assumes the Legislative Council Staff December 2023 school finance local share property tax revenue forecast until property tax year 2026. Estimates also incorporate the Office of State Planning and Budgeting's March 2024 forecast for K-12 funding, including marijuana revenues, federal mineral lease revenues, State Education Fund revenue and inflation through FY 2025-26. Future years adopt CU assumptions for longer-run growth in revenue, inflation, and enrollment.

To arrive at General Fund budget impact estimates of the three measures, first a base case (pre-SB24-233) model was run. To model the impacts of SB24-233 and Initiative #108, proportional reductions in assessment rates were applied to a weighted average of applicable property classes. To model the impacts of Initiative #50, school finance property tax revenue was limited to 4% growth in any given year. To determine the school finance impact of measures, estimates under the three measures were compared to base case estimates.

Models were run for both a baseline economic scenario of continued growth and a recessionary scenario. Property tax revenue growth assumptions are summarized in Table Four on the following page.

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Table Four:
Local Share Property Tax Revenue Growth Assumptions

Baseline Scenario

Tax Year	Base Case	SB24-233	#50	#108	#50 & #108
2024	10.3%	0.7%	10.3%	10.3%	10.3%
2025	1.7%	9.5%	1.7%	-17.3%	-17.3%
2026	0.8%	-1.0%	0.8%	0.8%	0.8%
2027	6.0%	6.0%	4.0%	6.0%	4.0%
2028	1.8%	1.8%	1.8%	1.8%	1.8%
2029	6.0%	6.0%	4.0%	6.0%	4.0%
2030	1.8%	1.8%	1.8%	1.8%	1.8%
2031	6.0%	6.0%	4.0%	6.0%	4.0%
2032	1.8%	1.8%	1.8%	1.8%	1.8%
2033	6.0%	6.0%	4.0%	6.0%	4.0%
2034	1.8%	1.8%	1.8%	1.8%	1.8%
2035	6.0%	6.0%	4.0%	6.0%	4.0%

Recessionary Scenario

Tax Year	Base Case	SB24-233	#50	#108	#50 & #108
2024	10.3%	0.7%	10.3%	10.3%	10.3%
2025	1.7%	9.5%	1.7%	-17.3%	-17.3%
2026	0.8%	-1.0%	0.8%	0.8%	0.8%
2027	6.0%	6.0%	4.0%	6.0%	4.0%
2028	1.8%	1.8%	1.8%	1.8%	1.8%
2029	-2.0%	-2.0%	-2.0%	-2.0%	-2.0%
2030	1.8%	1.8%	1.8%	1.8%	1.8%
2031	8.0%	8.0%	4.0%	8.0%	4.0%
2032	1.8%	1.8%	1.8%	1.8%	1.8%
2033	8.0%	8.0%	4.0%	8.0%	4.0%
2034	1.8%	1.8%	1.8%	1.8%	1.8%
2035	8.0%	8.0%	4.0%	8.0%	4.0%