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## ***ISSUE BRIEF: LEVY REFORM***

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*September 2016*

### **EXECUTIVE SUMMARY**

For decades Washington has been struggling with the issue of funding basic education. Central to those discussions has been the continued overreliance of local levies for basic education. Levy reform is an incredibly complex issue, one that is difficult to find solutions for and even more difficult to find agreement on those solutions.

This brief will provide a brief history on local levies in Washington, a synopsis of the main approaches to levy reform, and an overview of recent legislative proposals around levy reform. The discussion around different approaches and proposals will be at a relatively high level as the goal for this brief is not to delve too deeply into the details of levy reform, but rather to provide an overview of this challenge facing legislators and highlight how decisions around levy reform will have a potential impact on other non-education issues.

### **A BRIEF HISTORY ON LOCAL LEVIES IN WASHINGTON**

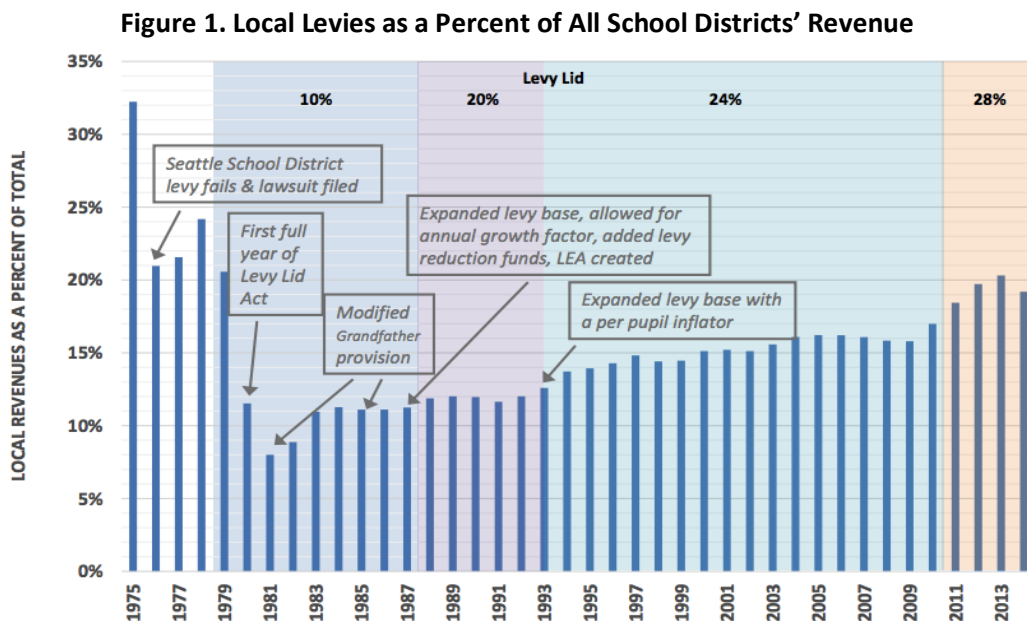
Local levies (also called excess levies) are property taxes approved by voters who live in the school district where a levy is proposed. These local levies are limited to one- to four-years and are intended to be used for school operations that fall outside the program of basic education. However, due to the state's failure to provide ample funding for basic education in accordance with Article IX, Section 1 of the state constitution, it has become regular practice amongst school districts who can pass levies to use levies for core basic education functions. It is especially common for local levies to be used to fund teacher compensation in an effort to offer higher salaries than the state currently funds in order to recruit and retain qualified teachers.

The misuse of local levies was one of the main components under the McCleary decision. The court ordered that the state may not rely on local levies to fund basic education, which means the state must both increase funding for basic education without having that funding come from local levies and also must end the current overreliance of local levy dollars for basic education through levy reform.

Levy Reform is not a new topic of debate in Olympia. Legislative and legal efforts to limit the overreliance on local levies date back to the 1970s when levies in some districts were higher than 30% of their funding sources. The 1978 Doran decision by the Washington Supreme Court made a similar ruling to the McCleary decision stating that, among other things, reliance on local levies was unconstitutional. In response to the Doran case, the legislature passed the Levy Lid Act in 1977, which put in place a cap that limited school district levies to 10% of a school district's basic education allocation from the state. Since that time, the legislature has

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repeatedly lifted that cap. The current rate has been temporarily lifted from 24% to 28% until 2018. The expiration of that temporary lift is known as the “levy cliff.” Figure 1 depicts how school districts’ use of local levies changed between 1975-2013.



Source: Senate Ways & Means Staff, *Understanding Washington’s Property Tax*, February 2015, <http://leq.wa.gov/Senate/Committees/W/M/Documents/Local%20Levies%20-%20SWM%2011Feb15.pdf>

There are two main arguments against the use of local levies to fund basic education:

**Adequacy** – Levies are dependent on the whim of the electorate and therefore cannot be considered a “regular and dependable tax source.” They are also temporary and vary greatly by district, which means they are not able to adequately meet the funding needs for basic education throughout the state.

**Equity** – Different areas are less likely to pass local levies, which means they are not reliable as an equitable source of funding. Even when a district is able to pass a levy, property values vary greatly from area to area and therefore if the property values are lower in an area they will not be able to generate as much revenue as a district with higher property values. This results in lower income districts being left with far less funding for basic education than other districts. There is a mechanism to help address some of this inequity – levy equalization. Under levy equalization the state provides money to districts that have difficulty raising local property taxes, but there are challenges with the sustainability of this program.

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Given these concerns around the use of local levies for basic education, it is widely believed that they should not be the funding source and instead the state must provide the funding. However, it has proven difficult to calculate how much local levies have been covering for basic education versus other programs and activities in schools. This makes it challenging to figure out how much the state needs to cover to make up the difference, and is therefore one of the main reasons the legislature has not yet addressed teacher and staff compensation for the McCleary decision. E2SSB 6195 summarized the issue by stating “the lack of transparency in school district data regarding how districts use local levy funds limits [the legislature’s] ability to make informed decisions concerning teacher compensation.”<sup>1</sup> Data is not clearly or consistently available that shows which teachers are doing basic education and which are providing enhancements or enrichment programs, and thus how much of local levies are being properly utilized versus misused. To address this issue, E2SSB 6195 provided funding for a consultant to collect data on all funding sources for staff compensation including local levies, established the Education Funding Task Force, and stated the commitment that legislative action would be taken by the end of the 2017 session to eliminate school district dependency on local levies to fund basic education.

Since the McCleary decision in 2012 the legislature has been working to tackle levy reform in order to be in compliance by the court’s deadline. In their August 13, 2015 order the court stated that they “offer no opinion on whether full state funding of basic education and salaries must be accompanied by levy reform...”<sup>2</sup> This created some initial confusion as to whether the court was backtracking on levy reform. However, in the same paragraph where the court says they offer no opinion around levy reform, they still state that the court has previously “determined that the State may not constitutionally rely on local levies to pay for basic education generally.” This means the state still needs to stop relying on local levies to fund basic education, but the court does not have an opinion regarding whether the legislature needs to use levy reform as a funding source. In other words, the court is indifferent to how the McCleary obligation is met, but local levies cannot be a funding source.

## **APPROACHES TO LEVY REFORM**

While there is much debate around what to do with local levies, there are two main approaches that have been used in most proposals – levy swap and restricting levies to enrichment programs.

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<sup>1</sup> Engrossed Second Substitute Senate Bill 6195, <http://lawfilesexternal.wa.gov/biennium/2015-16/Pdf/Bills/Session%20Laws/Senate/6195-S2.SL.pdf>

<sup>2</sup> August 13, 2015. Supreme Court of Washington, *Order No. 84362-7*, [http://www.courts.wa.gov/content/publicUpload/Supreme%20Court%20News/843627\\_081315McClearyorder.pdf](http://www.courts.wa.gov/content/publicUpload/Supreme%20Court%20News/843627_081315McClearyorder.pdf)

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## LEVY SWAP

The idea of a 'levy swap' involves increasing state property taxes with a corresponding reduction to local levies. This would both eliminate the use of local levies for basic education and also provide a statewide funding source for meeting the McCleary obligation. While there are different extents to which levy swap can be done and the details are very complex, this option has the appeal of being mostly revenue neutral. Proponents also argue that this approach reduces inequity in the system since revenue would be generated statewide and then redistributed based on the prototypical funding model approved by the legislature.

While a levy swap wouldn't provide enough revenue to fully meet the remaining funding needs for McCleary, it would cover a significant portion. The actual remaining cost of amply funding basic education is still unknown but the state has estimated it to be around \$3.5 billion. At least one levy swap proposal was estimated to produce about \$2.7 billion, thus addressing a large amount of the remaining funding needs.

**Concerns:** One of the main concerns voiced by opponents to this approach is that the increase in the state property tax would disproportionately impact urban areas more than rural areas. Even with a corresponding reduction in local levies, urban areas in the state tend to be more property-rich (such as Seattle and Bellevue) and therefore will pay more under this approach. While these urban areas would see an overall increase in their property taxes, other parts of the state will likely see their property taxes decline. In addition, even if the property tax impact on areas like Bellevue and Seattle end up being neutral, the districts would be receiving less money than they currently receive through local levies since the money would be collected and distributed statewide. This has sometimes made it a challenge to garner the support of legislators and school districts in these areas.

Rural and eastern Washington districts also have concerns, though different from those outlined above. School districts in these areas often have either no local levies or smaller levies, and that means a levy swap would result in a property tax increase. While this would be accompanied by an increase in state money to their school district, there may be voter opposition to the tax increase.

The concern has also been raised that this approach does not generate any *new* revenue for the state to spend on education; it simply shifts revenue. While this is viewed as a concern by some, others see it as positive.

## RESTRICT LEVIES TO ENRICHMENT PROGRAMS

The court has not stated that local levies must be reduced or eliminated; they have only said local levies cannot be used to fund basic education. Some legislators and stakeholders are

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advocating to keep existing local levies in place but eliminate their use for basic education. School districts would then divert those local levy dollars to enrichment programs that go beyond basic education such as extracurricular clubs, advanced placement programs, extra class periods, and after school programs.

**Concerns:** The concern around this option is that it removes levy reform as a possible funding source for basic education, which results in legislators needing to rely on other funding options such as new revenue (state property tax, capital gains, carbon tax), closing tax loopholes, or drastic cuts to existing programs. This means there could be an increased tax burden (in some form) on taxpayers throughout the state because they will continue to pay current state property taxes and current local levies, and then there will potentially be other new taxes imposed to meet the McCleary funding needs.

## RECENT LEVY REFORM PROPOSALS

The 2015 legislative session saw several proposals to start working on levy reform. None of the proposals would have fully addressed levy reform and none of them ultimately passed. However, they generated a great deal of bipartisan discussion around how to tackle this issue and the pros and cons of different approaches.

**House Bill 2239** – Introduced by Rep. Ross Hunter (D-Medina), this bill would have a series of deadlines for doing the work of reducing the reliance on local levies. The schedule would lead to a new financing system for basic education without the use of local levies.

**Senate Bill 6103** – Introduced by Sen. Jim Hargrove (D-Hoquiam), this bill would have implemented a plan to phase-in a compensation system for competitive wages. The bill reduced local levies by the same amount of any new K-12 salary enhancements allocated by the state. A revenue source for the state allocations was not specified.

**Senate Bill 6104** – Introduced by Sen. Christine Rolfes (D-Bainbridge Island), this bill would have implemented a plan to phase-in a revised statewide compensation system for staff that is fully state-funded. The bill established an ongoing comparable wage analysis every four years and created a work group around local levies. Reliance on local levies for basic education was phased out, but local levies were remained in place. This bill also included a phase-in plan for meeting K-12 class size reduction as passed under initiative 1351. The funding for this bill would have been accomplished through a capital gains tax.

**Senate Bill 6109** – Introduced by Sen. Bruce Dammeier (R-Puyallup), this bill would have implemented recommendations of the compensation technical working group. This included defining a new regional compensation model, shifting school employees to a state-

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run healthcare system, repealing teacher COLAs under initiative 732 and replacing it with a different inflation factor, and changing how school levy limits are calculated. The bill reduced local levies with a corresponding increase in the state property tax as outlined in the bill.

**Senate Bill 6130** – Introduced by a bipartisan group of legislators, this bill would have phased-in a ‘less complicated’ salary allocation model for school staff, required a comparable wage analysis every four years, provided specificity on how local levy funds may be spent, and established an education funding council. The bill would have reduced reliance on local levies by increasing state funding. A revenue source for the state allocations was not specified.

Committee staff compiled a [crosswalk](#) of several proposals that presents a comparison between the different components.

While none of these proposals passed, they did show bring to light many of the different approaches to levy reform being considered and highlighted that it will be a challenge for the legislature to ultimately reach an agreement.

## CONCLUSION

Levy reform is not a new issue facing legislators in Olympia. Concerns around the overreliance on local levies have been around for nearly forty years and though there continues to be great fluctuation in how much school districts use local levies for basic education, the issue has never been fully resolved. The 2017 legislature faces the looming challenge of needing to address levy reform in order to be in compliance with the McCleary decision. Even advocates who do not work directly on education issues will be monitoring this issue to see which approach is taken – will levy swap be the chosen path, which provides a revenue source for meeting some of the funding needed to meet the McCleary obligation? Will local levies remain in place and thus the legislature will need to find new revenue sources or make cuts to other parts of the budget, like health and prevention programs? Or will it be a combination of several different approaches? Either way, the discussions around levy reform will be central to legislative activity and budget negotiations in 2017.

*This publication was supported by National Center for Chronic Disease Prevention and Health Promotion of the Centers for Disease Control and Prevention under award number NU58DP004830.*

*The content of this publication is solely the responsibility of the authors and does not necessarily represent the official views of the Centers for Disease Control and Prevention.*

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