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TO: Interim Joint Committee on Education; Co-Chairs Sen. Max Wise and Rep. Regina Huff

FROM: Kentucky Department of Education

DATE: October 28, 2021

SUBJECT: Equitable Transfer of Education Funds Report

HB 563 (2021) and HB 405 (2021) require the Kentucky Department of Education (KDE) to provide reports related to the “equitable transfer of education funds” between resident and nonresident school districts by November 1, 2021. Please allow this Memorandum to serve as the required reporting. This report will discuss the applicable laws as well as available funding for school districts when a student is enrolled in a district other than where the student resides. A student attending a school district other than where they actually live is a “nonresident” student and the district of enrollment is the “nonresident” district. “Education funds” for purposes of this report include Support Education Excellence in Kentucky (SEEK) funds, other state funds, federal funds and local funds.

HB 563 and HB 405 provide as follows:

HB 563 (Section 4)

By November 1, 2021, the Kentucky Department of Education shall submit a report to the Legislative Research Commission and the Interim Joint Committee on Education with options on how to ensure the equitable transfer of education funds so that funds follow a nonresident student to a school district of enrollment from a school district of residence. The report shall include recommendations on how the amount should be calculated and what mechanism should be used to conduct the transfer.

HB 405 (Section 15)

By November 1, 2021, the Kentucky Department of Education shall submit a report to the Legislative Research Commission and the School Funding Task Force with options on how to ensure the equitable transfer of education funds so that funds follow a nonresident student to a school district of enrollment from a school district of residence. The report shall include recommendations on how the amount should be calculated and what mechanism should be used to conduct the transfer.

I. Under Current Law, School Districts Receive Funding for Nonresident Students

Currently, School Districts include nonresident students in their Average Daily Attendance (ADA) and thereby receive funding for nonresident students when they are included in a written agreement between the resident and nonresident district.

KRS 157.350 sets forth the eligibility requirements for school districts to participate in the fund to Support Education Excellence in Kentucky (SEEK). The statute states in pertinent part:

Each district which meets the following requirements shall be eligible to share in the distribution of funds from the fund to support education excellence in Kentucky:

(4) Includes no nonresident pupils in its average daily attendance, except:

(a) 1. Until July 1, 2022, pupils listed under a written agreement, which may be for multiple years, with the district of the pupils' legal residence.

(c) permits a district to include in its AADA nonresident students who attend a district where their parent is employed.

The SEEK program is the primary funding formula for providing state common school funds to local school districts. SEEK funding amounts are determined by a district's adjusted average daily attendance (AADA). Average daily attendance (ADA) is the total number of days of student attendance divided by the total number of days in the school year. AADA is a version of ADA that includes additions and subtractions pursuant to 702 KAR 7:125. Per KRS 157.350, districts with written agreements may include nonresident students in their average ADA (and thereby receive SEEK funding). These written agreements are known as nonresident agreements, contracts or reciprocal agreements and include a list of all nonresident students enrolled in the attending district. The agreements must be filed with the resident and nonresident districts no later than October 1st of the school year prior to the school year to which it will apply. (702 KAR 7:125 Section 8).

Nonresident agreements are not filed with KDE. Local School Districts of Enrollment are required to code the nonresident student status of enrolled students in Infinite Campus, the statewide student information system. Once the nonresident contract student is enrolled in the district, in accordance with the provisions of KRS 157.350(4), the student is accounted for the same as resident students for purposes of SEEK funding and any other funding opportunities that utilize ADA, including state grants and federal grants. State grants include competitive and formula awards and do not differentiate between resident or nonresident students. Likewise, federal funds do not differentiate between residents and nonresidents.

Nonresident Agreements

As stated above, in order for a district to currently receive funding for a nonresident student, the student must be listed in a written agreement between the resident and nonresident district. The terms of the written agreements vary among districts with some more generous in allowing the flow of resident students and their SEEK funding to nonresident districts. Two examples include an exchange of students "one for one" while others may allow "any and all" students to enroll in a nonresident district, irrespective of the counts for each district. Conversely, some districts severely limit the exchange of students between districts or do not enter into agreements at all. Districts are sometimes unable to reach an agreement on nonresident student enrollment. When districts are unable to reach an agreement, a district may appeal to the Commissioner of Education and ultimately to the Kentucky

Board of Education (KBE) pursuant to 702 KAR 7:125. In deciding a nonresident dispute between districts, KRS 157.350(4)(a)(5) requires the commissioner and KBE to consider factors affecting the districts, including but not limited to academic performance and the impact on programs, school facilities, transportation, and staffing.

II. HB 563 (2021) Amended KRS 157.350 and 158.120 to Require Districts to Adopt and Admit Students Pursuant to a Nonresident Policy by July 1, 2022

Effective July 1, 2022, districts no longer enter into nonresident agreements but are required to adopt nonresident policies and may include students so admitted in the district's ADA for funding purposes.

Among its provisions, HB 563 (2021) amended KRS 157.350 and KRS 158.120 to require districts to adopt nonresident policies by July 1, 2022. Per the amendments, districts will no longer enter into agreements regarding nonresident students. Rather, districts are required to adopt policies and may admit students pursuant to those policies without the acquiescence of the resident district. KRS 158.120 states:

By July 1, 2022, a board of education shall adopt a nonresident pupil policy to govern the terms under which the district shall allow enrollment of nonresident pupils. Upon allowing nonresident pupil enrollment, the policy shall allow nonresident children to be eligible to enroll in any public school located within the district. The policy shall not discriminate between nonresident pupils, but may recognize enrollment capacity, as determined by the local school district. The nonresident pupil policy and any subsequent changes adopted by a board of education shall be filed with the Kentucky Department of Education no later than thirty (30) days following their adoption.

This is a substantial change from the requirement that no nonresident student may be included in a district's ADA unless subject to a written agreement between the resident and nonresident district as discussed in Section I above. Nonresident agreements required a meeting of the minds between districts. When districts were unable to reach agreement, the Commissioner of Education and KBE were authorized to settle disputes. KRS 158.120, as amended, permits districts to enroll, and include in their ADA, students in accordance with the local board policy subject only to the requirement that the district not discriminate between nonresident pupils. Thus, on July 1, 2022, a district with a nonresident policy may admit, include in its ADA and receive SEEK funding for nonresident students subject only to the district's policy and without agreement from the resident school district.

Current processes for coding nonresident students will remain relatively unchanged. Local School Districts of enrollment will record the nonresident student status of enrolled students in Infinite Campus, the statewide student information system. Once the nonresident student is enrolled in the school district, in accordance with the provisions of KRS 157.350, nonresident students are accounted for the same as resident students for purposes of SEEK funding and any other funding opportunities that utilize ADA, including state grants and federal grants. KDE will continue to include nonresident student review in student attendance audits on a rolling sampling basis each year within selected districts.

III. Locally Raised Tax Revenue – the Local Effort

Under the current law requiring nonresident agreements and HB 563's amendments shifting to district nonresident policies, districts include nonresident students in ADA and receive state SEEK funding, but they do not receive local revenue funds from a nonresident student's district of residence.

Locally raised tax revenue or local effort are tax rates levied by local boards of education to help support local school districts. Pursuant to KRS 160.470, districts must levy a minimum equivalent tax rate of 30 cents per \$100 in taxed property in order to be eligible to receive SEEK funding. All of Kentucky's 171 local school districts meet the minimum equivalent tax rate requirements to participate in SEEK. Local tax revenue is comprised of a combination of property, motor vehicle and permissive taxes. Permissive taxes include utility, occupational and excise taxes. Local school districts are independent taxing authorities pursuant to KRS 160.455 and local districts vary in their decisions on the types and rates of taxes levied within their local communities. SEEK uses property tax assessments as part of the allocation methodology to distribute funds to districts; with lower property value assessment districts generating more SEEK funds, while districts with higher property value assessments receive less state funding from SEEK. Just as districts vary in the types of taxes and amounts levied, they vary in their ability to successfully collect taxes owed. The amount of taxes collected and received by the local school district does not equal the amount assessed. Depending on type, local taxes are collected either locally or by the Kentucky Department of Revenue. KDE has no jurisdiction over the collection of local revenues and is not part of the process of receipt or distribution of local revenues on behalf of local school districts.

Operationally, the equitable transfer of SEEK as representing the state base funding formula for students does not present any challenges for KDE whether the student is a resident or nonresident of the district provided the local district of enrollment is coding the student's status in Infinite Campus appropriately. Additionally, for any state grant or federal funds which flow through KDE to local school districts on behalf of enrolled students, there are no operational challenges. In limited cases, there are opportunities for school districts to apply to receive funds from other state or federal agencies.

IV. Options Considered for the Transfer of Local Revenue from Resident to Nonresident Districts and Legal Considerations

Transferring local revenue from resident districts to nonresident districts either directly or indirectly involves significant constitutional issues.

This report considers four options related to providing local funds or an equivalent amount of local funds for nonresident students. They are as follows: (1) nonresident districts include students in ADA and receive SEEK and eligible state and federal funds but do not receive any local funds or any amount to make up for local funds; (2) require resident districts to transfer local revenue funds directly to nonresident districts; (3) adjust SEEK payments so that nonresident districts receive additional SEEK funds for nonresident students while the resident district's SEEK payments are reduced by a corresponding amount; and (4) the General Assembly provides for a separate appropriation to nonresident districts to make up for the lack of local revenue.

1. No transfer of local funds

Should the General Assembly create a mechanism to transfer a share of locally raised tax revenues from one school district to another when admitting nonresident students?

In regards to providing districts with a share of local funds for nonresident students, the General Assembly could choose not to require the transfer of local revenues. As discussed above, under existing law, districts already admit nonresident students subject to written agreements. Students so admitted may be included in the district's ADA. Districts receive SEEK funding for these students as well as other state and federal funds based on ADA without regard to residency status. Districts receive federal funds pursuant to U.S. Census data or other

requirements of federal law that are not dependent on ADA nor residency status. However, nonresident districts do not currently receive any share of locally raised tax revenues from a student's resident district. Despite not receiving local funds, districts have long admitted students pursuant to these agreements.

With the enactment of HB 563, by July 1, 2022, districts shall adopt policies governing the admittance of nonresident students. Districts with the capacity that wish to enroll students will be free to do so pursuant to their locally enacted policies. These nonresident students will be included in the district's ADA, and the district will receive SEEK and eligible state and federal funding for the pupils. If a district does not have the capacity or chooses not to enroll nonresident students due to the inability to receive resident local revenues, then it will adopt a more restrictive nonresident student policy.

Option 1 avoids potential constitutional challenges related to the transfer of local revenue from resident districts to non-resident districts as discussed below in Options 2, 3 and 4.

2. Require resident districts to transfer local revenue funds to nonresident districts

Should the General Assembly require resident districts to transfer locally assessed and collected tax revenue to districts of enrollment to cover the lack of local revenue for nonresident students?

There are significant constitutional issues to be considered as to whether the General Assembly could create a law that requires a resident school district to transfer locally assessed and collected tax revenue directly to a nonresident school district that enrolls a student of the resident district. School districts will argue that requiring payment of local taxes assessed and collected by a resident district to a district of enrollment violates Section 180 of the Kentucky Constitution. Section 180 provides: "Every act enacted by the General Assembly, and every ordinance and resolution passed by any county, city, town or municipal board or local legislative body, levying a tax, shall specify distinctly the purpose for which said tax is levied, and no tax levied and collected for one purpose shall ever be devoted to another purpose." KRS 160.510 provides that the "tax collector shall... pay to the depository of the district board of education the amount of school tax collected..." Furthermore, KRS 160.530 states "the money collected by taxation... shall be expended by the board of education in accordance with the recommendations contained in the budget submitted to the Kentucky Board of Education." As a local taxing authority, school districts act to levy tax rates to support funding of local school facilities, safety measures and general operations of their districts.¹

School districts are equipped with years of precedent that taxes levied by a locally elected school board and paid for by residents within that school district were levied exclusively for that particular school district, not the state common school system at large. "To allow local citizens and taxpayers to make a supplementary effort in no way reduces or negates the minimum quality of education required in the statewide system."² If a tax were meant to support the state common school system at large, it should have been levied by the General Assembly for the state system of common schools. This is a strong argument for protecting established local revenue levied by the resident district from compelled payment to a nonresident district of enrollment. Therefore, Section 180 of the Kentucky Constitution likely protects local tax levies and the revenues collected from those levies for a particular school district from being obligated or devoted by the General Assembly to another school district.

3. Adjust the SEEK appropriation to provide additional funding for nonresident districts

¹ It should be noted that local funds dedicated to bond obligations may have additional challenges to transfer.

² *Rose v. Council for Better Educ., Inc.*, 790 S.W.2d 186, 212 (Ky. 1989)

Should the General Assembly, in lieu of requiring the direct transfer of locally assessed and collected tax revenue, create a SEEK formula adjustment that compensates nonresident districts for the lack of local funds by increasing funding for local school districts of enrollment while reducing funding for resident districts?

If the General Assembly will face legal barriers to requiring resident school districts to pay local taxes to attendance districts as discussed in Section 2, the next logical question is whether the General Assembly can decrease state funding³ to resident districts based on the number of students attending another district. In *Rose v. Council for Better Education*, the Kentucky Supreme Court held:

Section 183 requires the General Assembly to establish a system of common schools that provides an equal opportunity for children to have an adequate education. In no way does this constitutional requirement act as a limitation on the General Assembly's power to create local school entities and to grant to those entities the authority to supplement the state system. Therefore, if the General Assembly decides to establish local school entities, it may also empower them to enact local revenue initiatives to supplement the uniform, equal educational effort that the General Assembly must provide. This includes not only revenue measures similar to the special taxes previously discussed, but also the power to assess local ad valorem taxes on real property and personal property at a rate over and above that set by the General Assembly to fund the statewide system of common schools. Such local efforts may not be used by the General Assembly as a substitute for providing an adequate, equal and substantially uniform educational system throughout this state.⁴

Based on this directive from the Kentucky Supreme Court, the legislature stated its intent in KRS 157.310 that the SEEK system is not meant to “limit nor to prevent any school district from providing educational services and facilities beyond those assured by the state supported program.”

In *Rose*, the Kentucky Supreme Court was clear:

The system of common schools must be adequately funded to achieve its goals. The system of common schools must be substantially uniform throughout the state. Each child, *every child*, in this Commonwealth must be provided with an equal opportunity to have an adequate education. Equality is the key word here. The children of the poor and the children of the rich, the children who live in the poor districts and the children who live in the rich districts must be given the same opportunity and access to an adequate education. This obligation cannot be shifted to local counties and local school districts.⁵

As part of its common school funding mechanism, the General Assembly requires each local school district to levy a 30 cent ad valorem tax on real property located within each district as required local effort. Since this specific tax is uniform and required by the General Assembly for the entire Commonwealth, the General Assembly could arguably direct the distribution of this revenue as part of its common school funding formula. However, SEEK funding distributed to school districts is already reduced by the total amount raised via the required 30 cent local effort. To make any further reduction of state funds would risk the General Assembly not “providing an adequate, equal and substantially uniform educational system” as required by *Rose*.⁶ That is, the per pupil amount paid to

³ For the purpose of this section, the phrases “decrease state funding” and “reduction of state funding” means a specific reduction to the state education funding beyond the per pupil allotment that would naturally be eliminated by students no longer being counted in ADA.

⁴ 790 S.W.2d 186, 211–12 (Ky. 1989)

⁵ *Id.*

⁶ *Id.*

one school district in order to provide a constitutionally required adequate public education would ultimately be less than that paid to another school district simply because resident pupils choose to enroll in a different district. This reduction of state funds would compromise the adequacy of state funding to all students who remain in the school district and depend upon it for an equal opportunity for adequate education.

Furthermore, reduction of state funds for students attending a non-resident district arguably shifts the General Assembly's responsibility to adequately fund common schools from the state to local school districts in violation of directives in *Rose*. The General Assembly's SEEK formula should fully fund an adequate and equitable education in Kentucky's common schools. By decreasing the state funding to a resident school district in order to provide additional funds to an attendance district, the General Assembly: (1) recognizes its SEEK formula fails to fully fund an adequate education as required by *Rose*; (2) shifts the burden for funding an adequate education to local school districts; and (3) even further reduces the state funding for students who remain in the district of residence. Any reduction in state funding to resident districts (beyond the natural decrease in per pupil allotment) for students attending a non-resident district appears inconsistent with the constitutional requirement that the General Assembly provide for an efficient system of common schools as interpreted by the Kentucky Supreme Court in *Rose*.

4. General Assembly appropriation to provide additional funding for districts admitting nonresident students

Should the General Assembly create a separate appropriation outside of the SEEK formula to provide additional funds to districts of enrollment to compensate for the lack of locally assessed and collected tax revenue for nonresident students?

While not a transfer of funds between districts, this section considers whether the General Assembly could provide for a separate appropriation outside of SEEK for nonresident districts is substantially the same as in Option 3 above. As previously discussed, the General Assembly is constitutionally required to provide for an adequate and equitable system of public schools. If the General Assembly reduces SEEK funding to provide for a separate appropriation, any reduction of state funds for students attending a non-resident district shifts the General Assembly's responsibility to adequately fund common schools from the state to local school districts and potentially violates the *Rose* decision. In other words, the General Assembly's K-12 educational funding mechanism, the SEEK formula, must fully fund an adequate and equitable education in Kentucky's common schools. By decreasing the state funding to a resident school district in order to provide additional funds to the nonresident district, the General Assembly recognizes the SEEK formula fails to provide for an adequate and equitable education, and shifts the burden for funding to local school districts.

If the General Assembly holds SEEK funding steady or even increases it and provides for an additional separate appropriation in order to compensate nonresident districts for the lack of local funds, the same adequacy of state funding issue remains. The legislature may be challenged that the amount of state SEEK funding is inadequate to fully fund "an efficient system of common schools", and the lack of sufficient funding requires the General Assembly to create an appropriation for such districts to cover locally assessed and collected revenue.⁷

V. Calculation and Mechanism for Transfer of Education Funds

As set forth above, there are existing mechanisms to provide for the calculation and distribution of SEEK and applicable state and federal grant funds for nonresident students to districts of enrollment. Relative to local tax

⁷ *Id.*

revenues, there would be no required changes to current operations at the state level for Option 1 where there is no contemplated transfer of local funds.

Options 2, 3 and 4 would require the development of methodologies to calculate and transfer funds. This would be more difficult to determine in the first year of implementation due to the timing of the completion of district Annual Financial Reports. Calculations for the equitable transfer could consider a determination of the amount of local revenue collected by the resident district for the preceding year which would transfer to the district of enrollment either directly in Option 2 or through an adjustment to SEEK at the state level in Option 3 in the successive year. If a separate appropriation is made as set forth in Option 4 above, the appropriation amount could consider the current numbers of nonresident students collected in Infinite Campus and either assess a per-pupil amount for each student as a supplemental funding or determine the amount of local revenues generated for current nonresident students. It should be noted that the KDE does not currently have automated systems that would be able to quickly generate the calculations for each of Options 2, 3 and 4 as set forth herein.

KDE appreciates the opportunity to comment on possible options for the implementation of the provisions of HB 563 and remains available to discuss further the information provided in this report.