



Local Composite Index

Human Development and Education Committee
July 30, 2015

Overview of LCI

- The General Assembly determines the amounts the state and local governments will pay for K-12.
- The state uses a local composite index to pinpoint a school division's ability to pay for the local required share of education costs for the Standards of Quality.
- The index also determines the amount of funding the state is required to make for the SOQ.

Overview continued

- The LCI is calculated every two years.
- It considers property value, adjusted gross income, taxable retail sales, and the student and total population in each school division.
- For the 2016 session, the McAuliffe Administration will calculate and use a new LCI in its K-12 budget recommendations

Overview continued

- The index compares the size of a locality's tax base (relative to its population and number of students in public school) to the statewide size of local tax bases (relative to statewide population and overall number of public school students.)
- The index is supposed to show how much revenue per person and per student a local government has.

Composite Index of Local Ability-to-Pay Formula

ADM Component =

$$.5 \left[\frac{\text{Local True Value of Property}}{\text{Local ADM}} \right] + .4 \left[\frac{\text{Local Adjusted Gross Income}}{\text{Local ADM}} \right] + .1 \left[\frac{\text{Local Taxable Retail Sales}}{\text{Local ADM}} \right]$$

$$\frac{\text{State True Value of Property}}{\text{State ADM}} \quad \frac{\text{State Adjusted Gross Income}}{\text{State ADM}} \quad \frac{\text{State Taxable Retail Sales}}{\text{State ADM}}$$

Population Component =

$$.5 \left[\frac{\text{Local True Value of Property}}{\text{Local Population}} \right] + .4 \left[\frac{\text{Local Adjusted Gross Income}}{\text{Local Population}} \right] + .1 \left[\frac{\text{Local Taxable Retail Sales}}{\text{Local Population}} \right]$$

$$\frac{\text{State True Value of Property}}{\text{State Population}} \quad \frac{\text{State Adjusted Gross Income}}{\text{State Population}} \quad \frac{\text{State Taxable Retail Sales}}{\text{State Population}}$$

Local Composite Index =

((.6667 x ADM Component) + (.3333 x Population Component)) x 0.45 (average local share)

Challenges for the LCI

- The LCI is complex and not easily understood.
- LCI does not measure students' educational needs. Instead, it effectively suppresses the state's funding obligation.
- A single change to the formula to one school division's LCI affects, either positively or negatively, all school divisions.
- The result is political paralysis in that the General Assembly is wary of both intended and unintended consequences.

More challenges

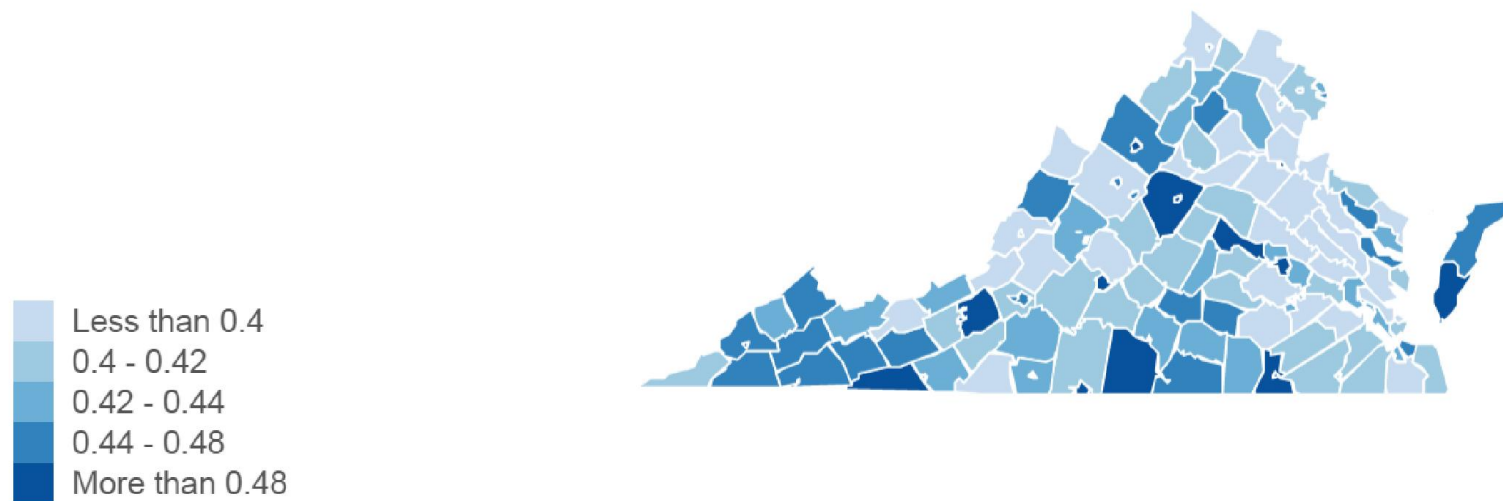
- When real estate values plunged after the housing bubble burst, particularly in Northern Virginia, the LCI for those localities, including Fairfax County, dropped and as a result, the LCI for other localities increased, some fairly dramatically.
- Under the LCI, the local true value of real estate, local adjusted gross income and local taxable retail sales are weighted according to how important these revenues sources were to total revenue sources when the LCI was developed in the 1970s – 40 years ago.
- The relative weights assigned to the tax bases no longer reflect the reality of local tax bases.

And yet more challenges

- The use of adjusted gross income as the proxy measure for the “other” tax base in the LCI is especially a problem.
- Localities in which a large percentage of income comes from a relatively few wealthy individuals look richer than they actually are.
- The City of Richmond is one such example.
- The city has the highest income inequality in the state, according to census figures.

Income inequality

The U.S. Census uses a widely accepted standard -- the "Gini Index" -- to measure income inequality. The index ranges from zero (a community where every household has the same income) to 1 (a community where one family earns all the income).



Source: American Community Survey (2012)

More problems with the LCI

- “Other” taxes include personal property; BPOL; permits, fees and licenses; fines and forfeitures; charges for services; revenue from use of money and property; and other miscellaneous sources.
- Not all localities have access to the taxes/fees included in the “other” category.
- JLARC found that the car tax reimbursement program raises questions about whether this source, which is the largest part of the “other” sources, should be included in the this category.
- The LCI does not take into account other services (social services, public safety, health, etc.) that localities have to provide. JLARC found a high correlation between population density and local spending on public safety, public works and health and welfare.

More problems continued

- Because of the political reluctance to tinker with the LCI and the K-12 funding formula, it may make more sense to instead ask JLARC to review funding formulae used by other states.
- Consideration should be given to basing required funding on the cost of educating students as opposed to the ability of a local government to generate revenue.

Proposed position on local composite index of ability to pay

- Education funding for the state's Standards of Quality (SOQ) should be based on the actual costs for school divisions to meet the Virginia Board of Education's Standards of Learning for students and Standards of Accreditation for schools. Also, the local composite index (LCI) is a crude and often inaccurate proxy for determining the ability of each locality to pay its share of K-12 expenses as defined by the SOQ. The Commonwealth's education funding formulae (SOQ and LCI) are more sensitive to the state's revenue situation than the educational needs of Virginia's students. VML supports a JLARC or other state study that examines the ways other states fund education and whether the Commonwealth should use a funding strategy that establishes a more realistic base foundation amount per pupil – plus add-on funding to reflect higher costs for educating at-risk, disabled, ESL, and gifted students.