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Understanding Adjustment Aid in New Jersey School Funding: *A Case Study of Jersey City*

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One of the most misunderstood aspects of New Jersey's school funding formula is the role of adjustment aid, one of several school aid categories paid directly by the state. Although adjustment is distributed to over 100 districts across the state, this policy brief focuses specifically on the unique circumstances facing Jersey City in an effort to explain how and why adjustment aid is distributed and its importance in ensuring school districts have enough funds to provide a thorough and efficient education. This report is also intended to clear up some common misconceptions about school funding in Jersey City – which is often characterized as an increasingly wealthy city that shirks its responsibility to fund its public schools – and offer recommendations to ensure all students have the resources needed for academic success.

School Funding Background

In 2008, the New Jersey Legislature enacted the School Funding Reform Act (SFRA), a new school funding formula that dramatically changed the method for funding schools across the state. The SFRA is a weighted-student formula that calculates state and local funding based on the resources needed to support the state's core curriculum and delivers extra funding to support programs for poor (at-risk) students, limited-English proficient (LEP) students, and students with disabilities.

The central feature of the SFRA is the development of an "adequacy budget" based on the cost of necessary education resources and each district's unique characteristics and student population. The SFRA determines the amount each district is expected to raise in local revenue to support its adequacy budget, called Local Fair Share (LFS). The LFS is based on local property wealth and personal income. The difference between the LFS and the adequacy budget is made up by state aid. A portion of special education, security, and transportation costs are provided as fully state-supported categorical grants outside the adequacy budget.

In the 2017-18 school year, 145 districts, or one in four, had a "local levy gap," where the amount of local revenue raised is below the LFS. Two-thirds of the districts with a local levy gap are spending below their adequacy budgets. The SFRA doesn't require these districts to raise their local revenue to the LFS level and close their local levy gap. The decision to raise local revenue – through an increase in the property tax – is left to the discretion of local boards of education.

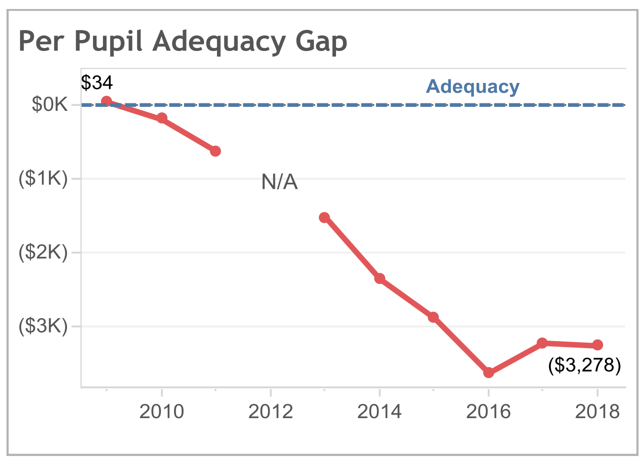
Furthermore, increases in local revenue from year to year are statutorily capped at 2% of the prior year's revenue amount. This cap limits the amount that can be raised each year and effectively lengthens the time – often significantly – required to close the local levy gap.

SFRA Implementation in Jersey City

When the SFRA was first implemented in 2008, the Jersey City Public Schools (JCPS) were in a position not faced by many other districts across the state. JCPS was spending approximately at its adequacy budget. Yet, due to historical factors, the budget was supported by state aid at much higher levels than the formula required, while the district was providing local revenue far below its LFS. In other words, JCPS had a local levy gap, by far the largest gap in the state.

To prevent a sudden cut in funding, the SFRA provided a separate aid category called "adjustment aid," not just to Jersey City but also to similarly situated districts across the state. Adjustment aid was designed to protect Jersey City and other districts from a significant loss of state aid as the districts transitioned to the new formula. The SFRA provided that the district's state aid would remain flat for a three-year transition period, after which adjustment aid would be reduced only if the district experienced a significant enrollment decline. Jersey City's adjustment aid was $111 million, by far the highest in the state.

Between 2009 and 2018, JCPS's adequacy budget increased by 25%, due to a small enrollment increase, shifting student demographics and rising per pupil costs, as calculated each year under the SFRA. However, Jersey City's LFS grew at an even faster pace – 35% – meaning that the district is expected to provide an even greater percentage of its funding through local revenues. Because adjustment aid only keeps the district at its funding levels from 2009, the district has seen no increase in state aid over this period and has actually fallen further and further below adequacy. In other words, Jersey City is increasingly reliant on adjustment aid because it is unable to increase the local levy to keep pace with its growing adequacy budget and its increasing obligation to fund its budget through local revenues.

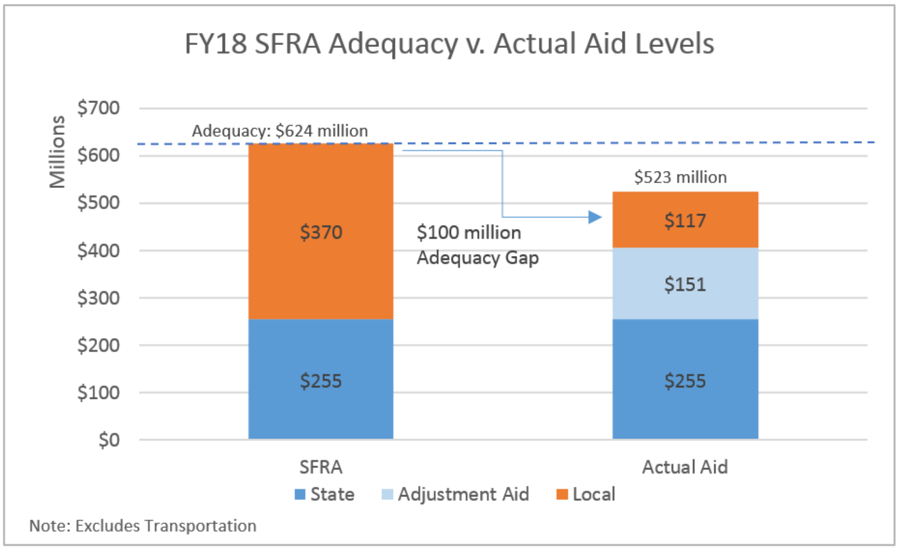


For the 2017-18 school year, the FY18 State Budget reduced adjustment aid in districts across the state as a revenue source to increase funding in other districts. The amount of the aid cut was limited to either 1.5% of a district's total operating budget or 2% of its total state aid. In Jersey City the cut was the highest in the state at $8 million. The adjustment aid cut resulted in Jersey City having to reduce expenditures to balance its budget, even though the district is currently spending below adequacy as calculated by the SFRA.

As the Governor and Legislature work on the FY19 State Budget, it is crucial to have a proper understanding of Jersey City's unique position under the SFRA and the importance of not reducing state aid given that the district's budget remains below its adequacy level.

1. Jersey City Public Schools Are Not Adequately Funded

In 2017-18, JCPS was about $100 million, or almost $3,300 per pupil, below adequacy under the SFRA. The district's SFRA adequacy budget is approximately $625 million – $370 million should be funded through local revenue and $255 million from state aid.[1] In reality, the district's revenues total only $523 million – $117 million from the local levy and $406 million in state aid ($255 million in equalization and categorical aid plus $151 million in adjustment aid).



2. Jersey City's Adjustment Aid Is Not Excess Funding

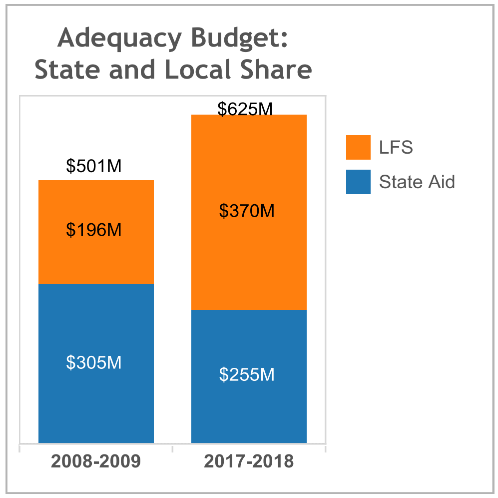
JCPS receives more state aid for its adequacy budget than the formula would provide because of its allocation of transitional adjustment aid under the SFRA. However, this does not mean that the district is "overfunded," "overaided," or spending in "excess" of what students need for a thorough and efficient education. In fact, adjustment aid does not fully cover the district's $253 million local levy gap.

[1] The report uses the "adequacy as defined" concept developed by the NJ Department of Education to evaluate districts' standing in their annual state aid notices. It adds the categorical funding amounts for special education and security to the adequacy budget, but excludes Transportation. To maintain a fair comparison, actual funding levels also exclude Transportation.

In other words, adjustment aid in Jersey City does not fund spending in excess of the level required under the SFRA for a thorough and efficient education for all district students. Even with adjustment aid, the district is spending $100 million below its adequacy target. A reduction in adjustment aid would have a severe impact on the district, further eroding the resources that are required to adequately educate all students to the state's academic standards. For example, using average district compensation levels ($99,158 annual salary plus benefits), the total loss of $151 million in adjustment aid would require the district to cut over 1,500 positions, or one-half of all certificated staff.

3. As Jersey City's Economy Grows, So Does the City's Obligation to Fund Its Schools

As mentioned above, the SFRA determines the state and local share of the adequacy budget relative to each district's ability to pay. The calculation of "local fair share" under the SFRA includes measures of personal income and property values. Because Jersey City is undergoing rapid redevelopment with rising property values, the amount of money that the district is expected to contribute has increased considerably since the SFRA was first enacted.



In 2009, the district was expected to contribute $196 million, or 39%, of the adequacy budget. In 2018, the expected contribution nearly doubled, going up 188%, to $370 million, or 59% of the budget. In comparison, the average district saw only a 27% increase in LFS over this time period.

4. Jersey City Has Increased its Local Revenue as Allowed Under the SFRA

In fact, Jersey City has increased its local levy considerably from $86 million in 2009, to $117 million in 2018, a 35% increase. The average district increased its levy by only 24%. However, that still leaves Jersey City $253 million below its local fair share under the SFRA. The city would have to more than triple its local levy to reach the required level.

In addition to the political and economic feasibility of increasing property taxes so dramatically, especially on homeowners, school districts have been constrained by the SFRA's annual 2% cap on property taxes since 2010, with some allowances for increasing health care and pension costs or enrollment growth. Jersey City has generally increased taxes to the 2% cap, but failed to capture some available revenue. For example, the district could have raised an additional $4 million in 2018 to offset increases in health care costs. This revenue, however, remains available for use as "banked cap" for the next three years.

The $8 million cut in adjustment aid in 2017-18 further set the district back in its efforts to fund its adequacy budget. And the state-imposed 2% property tax cap prevents the district from making up these cuts with local revenue, pushing the district even further below adequacy.

5. Real Estate Abatements Are Problematic but Eliminating Them Won't Solve the Local Levy Gap

Jersey City's practice of giving long- and short-term tax breaks to commercial and residential developments has long been the subject of criticism, and reform of the process may be necessary. However, it will not solve the problem of Jersey City's substantial local levy gap.

The LFS is determined based on a combination of personal income and property values, but the total equalized property value, adjusted to reflect true market value, does *not* include the value of tax-abated properties. The formula acknowledges that the district is unable to raise revenue off those properties and does not include them in the LFS calculation. If those properties were not abated, and instead were required to pay taxes, the LFS would reflect the district's ability to raise additional revenue and shift an even greater portion of the adequacy budget from the state to the city.

But the 2% property tax cap would still apply, and the district would not be allowed to raise the levy above the cap to leverage funding from its growing tax base.

6. PILOT Funds from Tax Abatements Have Not Supported the JCPS Budget

Municipalities are often partially compensated for the lost tax revenues from abated property through payments in lieu of taxes (PILOT) agreements. According to Jersey City's 2017 municipal budget, the assessed value of the tax-abated property was nearly $3 billion. The city collected $138 million from PILOT agreements, but none of that money went to the school district. If the PILOT funds were allocated in the same proportion as current property taxes – 50% municipal, 25% school district, 25% county – the school district could have received an additional $34 million. But given that these agreements have already been struck, the opportunity for that revenue has been lost.

In April 2017, Jersey City Mayor Steve Fulop issued an executive order requiring 10% of the revenue from future PILOTs be directed to public schools. While this is a promising development, it only applies to future agreements, thus the immediate impact on schools will be minimal. Moreover, the 10% is far below the overall share of the city's property tax revenue that supports the schools.

Recommendations

Unfortunately, there is no short-term or easy fix to address the revenue problem causing the underfunding of Jersey City schools and other districts facing similar circumstances under the SFRA. The juxtaposition of a city whose economy is growing with a school system that is funded below adequacy requires multiple, long-term policy solutions.

Contrary to much speculation, JCPS has largely been living up to its obligation under the SFRA to increase local revenue for schools, but it is constrained by the state's property tax cap. Year after year, the SFRA requires Jersey City to support a greater portion of its budget, and yet at the same time it will not allow the district to raise more local revenue. Under these circumstances one thing is abundantly clear: there is no excess state aid in the Jersey City budget, including adjustment aid, that can be cut without causing the district to fall further below its adequacy budget, decreasing the resources necessary to afford district students a thorough and efficient education.

But the Legislature could take some immediate steps that would put make it possible for JCPS to secure more local revenue to support its adequacy budget and close the large local levy gap at a quicker pace. While Jersey City represents an extreme case, these recommendations would benefit many other districts across the state that are in similar circumstances – drastically below their local fair share and below adequacy, but unable to meaningfully increase their local contribution because of state policy seeking to control property taxes. Recommendations include:

1. **Prohibit any further cuts to adjustment aid in districts spending below adequacy and where the cut would move the district further from adequacy.** As occurred in 2017-18, cuts to adjustment aid in below adequacy districts drive spending even further below the level required for a thorough and efficient education. Below adequacy districts need a viable, longer term plan to move towards adequacy through some combination of continued state support and realistic expectations for raising the local contribution.

2. **Raise the property tax cap for below adequacy districts with large local levy gaps.** The Legislature should revisit the current 2% cap on annual increases in local revenue in school districts that are spending below adequacy due to significant local levy gaps. When the SFRA was enacted in 2008, the property tax cap was at 4% annually. Raising or lifting the cap for below adequacy districts with large levy gaps would allow Jersey City and other similarly situated districts to increase spending and move to the "thorough and efficient" level more quickly.

3. **Require increases in local revenue in below adequacy districts that refuse to close large levy gaps.** Under the SFRA, districts that are below adequacy due to a large local levy gap are not required to raise local revenue to close that gap, even to the 2% annual cap. Where municipalities in such circumstances refuse to raise local revenue for the schools to the cap, despite the fiscal capacity to do so, the Legislature must either amend the SFRA to require a local tax increase or give the Commissioner of Education firm authority to compel the increase to ensure a school budget that delivers a thorough and efficient education.

4. **Mandate a fair share of future PILOT agreements for schools.** As evidenced by Jersey City's growing school population – especially in preschool, where enrollment has increased by 17% or nearly 700 students – redevelopment affects schools directly, and the district should be compensated fairly with a reasonable share of PILOT funds.

5. **Require a municipal contribution to the school levy to make up for the lost revenues resulting from past PILOT agreements.** The practice of excluding the school district completely from existing PILOT decisions has been catastrophic. Municipal governments should provide some relief by transferring revenue from the municipal budget to support the schools.