THE ALLOCATION OF URBAN IMPACT AID: A REVIEW

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INTRODUCTION

The Urban Impact Aid (UIA) program was established by Chapter 894, Statutes of 1977 (AB 65), in order to compensate certain urban school districts for the higher costs that some believe are associated with providing education in an urban setting.

General Fund support for the program has ranged from $36.7 million in 1976-77 to $75.4 million in 1985-86. Program funds are provided outside of the recipients' revenue limit (general aid) allocations, and for this reason UIA funds are not subject to the school finance equalization formulas that are used by the state to comply with the California Supreme Court's decision in the Serrano v. Priest case. Unlike other categorical aid, UIA funds need not be expended for any specific activity; these funds may be used to support any of the activities that local school districts are authorized to conduct.

Between 1977-78 and 1983-84, UIA was provided only to 19 large, unified school districts. The eligibility of these districts for UIA was established on the basis of three criteria:

- average daily attendance (ADA) in 1975-76;
- the number of children in the district whose families received Aid to Families with Dependent Children (AFDC) in 1975-76; and
- the poverty, ethnicity, and transiency of district residents in 1976-77.

The allocation of UIA to these 19 unified districts continues to be based on data for these years.

Senate Bill 813 (Chapter 498, Statutes of 1983) expanded eligibility for UIA to nonunified school districts. The act provided that the allocation of funds to these districts was to be determined using the same criteria and data used to allocate funds among unified school districts. One year later, the Legislature appropriated $9.2 million to further expand the program. In doing so, however, the Legislature required that the expansion funds be allocated using more recent data. Subsequently, the Legislature enacted Chapter 482, Statutes of 1984, which amended the Education Code to provide that the allocation of UIA funds to nonunified districts shall be based on ADA and AFDC counts for 1982-83.

As a result of legislative action in 1984, 12 high school districts and their 94 feeder elementary districts were added to the program, and are now receiving UIA allocations based on ADA and AFDC counts in 1982-83. (The 19 unified districts continue to receive their allocations based on 1975-76 ADA and AFDC count data.)

Chapter 482 also required the Legislative Analyst to study the distribution of UIA. Specifically, it required the Analyst to:

- Reassess the rationale and purposes of UIA funding;
- Examine the distribution of UIA relative to whether that distribution results in wealth-related expenditure disparities among school districts;
- Develop alternatives for distributing UIA which involve the phasing in of updated data and the assessment of the probable fiscal and programmatic impact of each alternative; and

- Make recommendations for legislative action on the distribution of UIA for the 1985-86 fiscal year.

This report was prepared in compliance with the directive contained in Chapter 482. It is organized into four chapters, as follows:

Chapter I. How Urban Impact Aid is Allocated

Chapter II. Effects of Urban Impact Aid on Wealth-Related Expenditure Disparities

Chapter III. Reassessment of the Rationale for Urban Impact Aid

Chapter IV. Alternatives for Distributing Urban Impact Aid

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SUMMARY OF FINDINGS AND RECOMMENDATIONS

I. FINDINGS

1. Urban Impact Aid (UIA), budgeted at $75.4 million in 1985-86, is distributed to 19 large unified districts and 106 nonunified districts which generally have above-average concentrations of disadvantaged students (pages 6-8).

2. The formula used to allocate UIA relies on data which, in the case of unified districts, is 10 years old (pages 11-12).

3. School districts with lower-than-average revenue limits per pupil tend to receive slightly higher amounts of UIA per pupil than do districts with higher-than-average revenue limits (pages 16-17).

4. The allocation of UIA does not result in wealth-related disparities, and neither significantly reduces nor exacerbates disparities in educational spending per pupil, as measured by the standard used in the most recent Serrano decision (pages 17-19).

5. The commonly-accepted rationale for UIA is that this aid is intended to compensate districts for the higher costs believed to be associated with an urban setting (page 20).

6. There is limited evidence that school districts in metropolitan areas face above-average prices for needed resources and services than are faced by other types of districts. However, about one-fourth of the districts eligible for UIA appear to face lower-than-average costs (page 22).

7. It is not known how effectively UIA achieves its intended purpose because (1) the allocation of aid bears little relationship to variations in the price of resources faced by different districts (page 21), and (2) it is not known how well UIA compensates districts for costs associated with unusual needs, or the provision of compensatory education (pages 23-24).

8. To the extent that the factors used in the UIA formula are valid measures of costs, however, UIA funds could be better targeted if more recent data were utilized in the distribution formula (page 25).

II. RECOMMENDATIONS

1. We recommend that entitlements to UIA be updated annually to reflect the most recent data (pages 27-28).

2. We recommend that the distribution of UIA be based on an average of need indicators for the three most recent years, in order to even out funding fluctuations from year to year and to help districts adjust to sudden revenue losses (pages 34-38).

3. We recommend that school districts which lose eligibility for UIA have UIA phased out over a five-year period, in order to allow these districts enough time to adjust to revenue losses. We recommend that the phase-out be implemented by computing these districts' UIA allocations based upon a five-year moving average of need indicators (pages 39-40).

CHAPTER I

HOW URBAN IMPACT AID IS ALLOCATED

Urban Impact Aid (UIA) is distributed using a two-step process, as specified in Ch 894, Statutes of 1977. The first step is to determine which districts are eligible to receive UIA. (For purposes of making this determination, high school districts and their respective feeder elementary districts are considered as one district.) The second step involves allocating available funds among the eligible districts.

HOW ELIGIBILITY FOR UIA IS DETERMINED

Eligibility for UIA is based on a complicated set of criteria that are specified in statute. These criteria define certain threshold scores that districts must surpass in order to receive funds. The criteria generally fall into three categories: (1) school district size, (2) urban impaction, and (3) poverty population.

District Size. To be eligible for UIA, unified districts must have had average daily attendance (ADA) of 12,022 or more in 1975-76, while high school districts and their feeder elementary districts must have had a combined ADA of 12,002 or more in 1982-83.

Urban Impaction. For a unified district to be eligible for UIA, it must have qualified for Educationally Disadvantaged Youth (EDY) aid in 1976-77. To receive an EDY allocation in that year, a district had to have an "EDY factor" of 0.9 or greater.

The EDY factor measured the district's relative concentration of transient pupils, pupils in potential need of bilingual services, and pupils from homes with incomes below the poverty line. (The EDY program has since been superseded by the Economic Impact Aid program.) Districts with an EDY factor of 1.0 had a concentration of students in these categories that resembled the statewide average. Districts with factors below 1.0 were slightly less "impacted" than the average, while districts with factors above 1.0 were more impacted.

A contemporary analog to the EDY factor is used to assess the eligibility of high school districts and their feeder elementary districts for UIA. These districts must have a combined Economic Impact Aid (EIA) "gross need" factor of 0.9 or greater. The EIA gross need factor is computed in a manner similar to the EDY factor (which is no longer in use).

Poverty Population. Finally, a unified district, or a high school district and its feeder districts, must have enough children from families receiving AFDC so that when the number of these children is multiplied by the EDY or EIA factor, the product equals or exceeds 3,731.

These criteria comprise the eligibility "threshold." Only districts scoring above the threshold receive UIA.

To date, 19 unified school districts, 12 high school districts, and 94 elementary school districts (feeders to the high schools) have been found to be eligible under these criteria.

HOW UIA IS ALLOCATED

Each fiscal year, the Legislature appropriates funds for UIA. The amount appropriated has ranged from $36.7 million in 1978-79, to $75.4 million in 1985-86. While the Legislature is free to appropriate any amount it chooses for UIA, since 1979-80, it usually has appropriated the prior year amount, increased to adjust for inflation.

The total amount of UIA available in any given year is divided among eligible districts, based on each district's "eligibility number." The eligibility number is determined by (1) multiplying each district's AFDC count times its EDY or EIA factor and (2) multiplying the product of these two numbers by the districts' base revenue limit per ADA. Funds are then allocated in direct proportion to these eligibility numbers. For example, a district with an eligibility number twice as large as another district's would receive twice as much UIA. Four large districts with ADA exceeding 58,800 receive an extra bonus, since their eligibility numbers are raised by 10 percent.

Table 1 illustrates how UIA has been allocated among the 19 eligible unified districts. The last column of the table shows what portion of the UIA appropriation has been provided to each school district. The table shows that more than one-half of UIA funds have been distributed to Los Angeles (51.0 percent). The next two largest allocations have gone to San Francisco (7.2 percent), and Oakland (6.7 percent).

Table 1

Urban Impact Aid Allocations to Unified Districts
1977-78 to 1985-86

	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Percent of Total UIA Funds Claimed by District
Berkeley	$243,792	$139,876	$208,443	$208,443	$220,950	$220,949	$234,206	$241,229	$250,878	0.4%
Oakland	4,301,140	2,467,779	3,677,475	3,677,475	3,898,124	3,898,111	4,131,998	4,255,913	4,426,145	6.7
Richmond	1,102,590	632,611	942,714	942,714	999,277	999,274	1,059,230	1,090,995	1,134,634	1.7
Fresno	2,241,460	1,286,038	1,916,449	1,916,449	2,031,436	2,031,429	2,153,315	2,217,891	2,306,604	3.5
Baldwin Park	530,650	304,460	453,705	453,705	480,927	480,925	509,781	525,069	546,071	0.8
Inglewood	710,667	407,745	607,620	607,620	644,077	644,075	682,719	703,193	731,320	1.1
Long Beach	1,779,703	1,021,104	1,521,645	1,521,645	1,612,944	1,612,938	1,709,714	1,760,987	1,831,425	2.8
Los Angeles	32,627,667	18,720,124	27,896,655	27,896,655	29,570,454	29,570,352	31,344,573	32,284,566	33,575,908	51.0
Montebello	1,619,420	929,142	1,384,604	1,384,604	1,467,680	1,467,675	1,555,735	1,602,390	1,666,484	2.5
Pasadena	1,030,789	591,415	881,324	881,324	934,203	934,200	990,252	1,019,949	1,060,745	1.6
Pomona	1,010,992	580,057	864,399	864,399	916,263	916,260	971,236	1,000,362	1,040,375	1.6
Compton	3,357,908	1,926,600	2,871,012	2,871,012	3,043,273	3,043,263	3,225,859	3,322,599	3,455,498	5.3
Santa Ana	802,251	460,291	685,924	685,924	727,079	727,076	770,701	793,814	825,566	1.3
Sacramento	1,782,417	1,022,662	1,523,967	1,523,967	1,615,405	1,615,399	1,712,323	1,763,674	1,834,218	2.8
San Bernardino	1,553,084	891,082	1,327,887	1,327,887	1,407,560	1,407,555	1,492,008	1,536,752	1,598,220	2.4
San Diego	2,202,052	1,263,427	1,882,754	1,882,754	1,995,719	1,995,712	2,115,455	2,178,895	2,266,048	3.4
San Francisco	4,629,629	2,656,250	3,958,333	3,958,333	4,195,833	4,195,819	4,447,568	4,580,946	4,764,178	7.2
Stockton	1,852,803	1,063,046	1,584,147	1,584,147	1,679,196	1,679,190	1,779,941	1,833,320	1,906,650	2.9
San Jose	620,986	356,291	530,943	530,943	562,800	562,798	596,566	614,456	639,033	1.0
Total	$64,000,000	$36,720,000	$54,720,000	$54,720,000	$58,003,200	$58,003,000	$61,483,180	$63,327,000	$65,860,000	100.0%

Source: Department of Education.

Nonunified Districts. Senate Bill 813 (Chapter 498, Statutes of 1983) extended eligibility for UIA to nonunified districts, beginning in 1984-85. This measure provided that each high school district, along with its feeder elementary school districts, shall be considered one unified district for purposes of calculating its UIA eligibility. Chapter 482, Statutes of 1984, requires that high school districts and their feeder elementary school districts be considered separately when UIA is allocated among districts. Consequently, the allocation of UIA to nonunified districts is based on each individual district's eligibility number.

Table 2 indicates how UIA is allocated among the 12 eligible high school districts and their feeder elementary districts. (In the table, funding associated with feeder elementary districts is combined with the amounts allocated to the recipient high school districts.)

Table 2

Distribution of Urban Impact Aid
to Nonunified Districts
(in thousands)
1984-85

High School District[a]	Amount
Kern	$860
Alhambra	899
Centinella Valley	409
El Monte	774
Whittier	424
Merced	496
Grant	1,091
Chaffey	525
Sweetwater	1,121
East Side	1,621
Modesto	443
Oxnard	553
Total	$9,216

a. Includes funds provided to feeder elementary school districts.

UIA DATA NO LONGER REFLECT NEED

As noted above, the statutes governing UIA specify that data on districts and their students from a fixed point in time be used in determining the districts' "need" for UIA funds. Table 3 lists the data used in the UIA calculations, and the year from which the data must be drawn. The table shows that the data used to establish entitlements for unified school districts reflect conditions which existed in the mid-1970's, while the data used to allocate UIA funds among nonunified districts reflect district circumstances in the early 1980's.

Because entitlements are based on data collected at a fixed time, each district's share of the available funds is frozen, and does not change

as the socio-economic condition of the district changes. Thus, under existing law, even though the "needs" of a district may change, the measures of need used to distribute funds never change.

Table 3

Source of Data Used in UIA Computations

Criterion	Type of Data	Year From Which Data Are Drawn: Unified	Year From Which Data Are Drawn: Nonunified
Size	ADA	1975-76	1982-83
Poverty Count	AFDC count	October 1975	October 1982
Base Revenue	Base revenue limit per ADA	1977-78	1984-85
Impaction	EDY or EIA factor, for use in compensatory education[a]	1976-77	1983-84

a. These factors involve measures of transiency, poverty, and number of bilingual students. The EIA factors are three-year averages.

CHAPTER II

EFFECTS OF URBAN IMPACT AID ON WEALTH-RELATED EXPENDITURE DISPARITIES

Chapter 482, Statutes of 1984, specifically requires the Legislative Analyst to examine whether the distribution of Urban Impact Aid (UIA) results in "wealth-related expenditure disparities among school districts." In this chapter, we examine the relationship between the distribution of UIA (on a per-pupil basis) and school district revenue limits. We do not address the extent to which the variation in revenue limits is wealth-related.

We examine the relationship between UIA allocations and revenue limits in two ways. First, we measure the extent to which the distribution of UIA is correlated with district revenue limits. That is, we attempt to determine whether school districts with higher-than-average revenue limits also tend to receive higher-than-average amounts of UIA per pupil. Second, we examine the potential effects of including UIA in the definition of general education expenditures per pupil.

BACKGROUND

The Serrano v. Priest Decision. In 1976, the California Supreme Court affirmed the lower court's 1974 ruling in the landmark Serrano v. Priest school finance case, which required that "wealth-related disparities in per-pupil expenditures, apart from categorical aids special needs programs" be reduced to "insignificant differences" of no more than $100 per pupil by 1980. As subsequent litigation has demonstrated, however, the

determination of what constitutes "wealth-related disparities" and the extent to which such disparities persist is not an easy task.

Originally, the term "wealth-related disparities" referred to differences in education spending per pupil that were caused by differences in local property values. Since the passage of Proposition 13 in 1978, however, local property tax values no longer determine the levels of local educational spending. Instead, the current school finance system used in California guarantees each school district an amount of general purpose funds equal to its "revenue limit" multiplied by its average daily attendance (ADA). This entitlement is funded through a combination of local property taxes and state aid. If local property tax collections increase due to increases in the assessed value of property within a school district, the amount of the district's state aid is reduced commensurately. (Because Proposition 13 imposed a 1 percent limit on ad valorem property tax rates, school districts no longer have the option of raising additional revenues by increasing tax rates.)

The revenue limit system does, however, cause remnants of past wealth-related expenditure disparities to be reflected in current spending differences. This is because each school district's revenue limit is based, in part, on the district's historical level of expenditures per ADA.

Subsequent Litigation. In 1980, a group of plaintiff school districts sought to have the state's school finance system once again declared unconstitutional, on the basis that it failed to comply with the court's decision in the 1974 Serrano case. Much of the argument in this

case turned on how compliance with the requirement to eliminate wealth-related expenditure disparities should be measured.

The plaintiff school districts argued that a standard of strict compliance should be adopted--one that would require the per-pupil general education expenditures of all districts to be within a "closure band" of $100. The plaintiffs, thus, assumed that all of the existing variation in per-pupil expenditures was wealth-related. The plaintiffs further argued that, in measuring the extent to which equalization has been achieved, the court should consider the percentage of school districts--rather than the percentage of statewide average daily attendance--that falls within the closure band. Finally, the plaintiffs contended that the definition of "general education expenditures" should include funds, such as the minimum revenue guarantee and the declining enrollment adjustment, which districts receive outside of their base revenue limits but which can be spent for any purpose. The plaintiffs, however, did not contend that UIA should be included within the definition of general education expenditures.

The State Department of Education (SDE), the defendant in the case, argued that the court should adopt a standard of "reasonably feasible" compliance which considers the amount of progress that the state has made toward achieving equalization. It also contended that the definition of general education expenditures should be limited to base revenue limit amounts only. In addition, the department produced evidence showing that no more than 30 percent of the variation in existing revenue limits was associated with (not necessarily caused by) past differences in property

wealth. Finally, the department argued that the court should use a variety of measures to assess the equity of the school finance system, but that if it chose to use a $100 "closure band": (1) the band should be adjusted for inflation which has occurred since 1974 and (2) the measurement of equalization should be based on the percentage of statewide ADA within the closure band.

In a decision issued in April 1983, Judge Lester Olson of the Los Angeles Superior Court found that the standard of compliance proposed by the SDE was appropriate. Relying on data showing the distribution of school district expenditures per pupil in 1982-83, Judge Olson further held that the state had complied with the terms of the earlier Serrano ruling, and that no further equalization was required. The decision is being appealed by the plaintiffs.

Methodology and Analysis

In assessing the effects of UIA allocations on expenditure disparities among districts, we employ the "closure band" approach proposed by the SDE and endorsed by Judge Olson.

Correlation Between Revenue Limits and UIA. Table 4 shows the relationship between the base revenue limits of UIA-recipient school districts and the amount of UIA received by these districts in 1984-85. As the table shows, there is a slight negative correlation between the distribution of UIA per pupil and the district's revenue limit. That is, districts with lower revenue limits tend to receive larger amounts of UIA per pupil. Specifically, while 93 percent of districts with high revenue

limits (over $2,310) are receiving no UIA in 1984-85, only 83 percent of districts with low revenue limits (less than $2,030) are receiving no UIA this year. Similarly, 8.4 percent of low revenue limit districts receive UIA in excess of $15 per pupil in 1984-85, while only 2.7 percent of high revenue limit districts do so.

Table 4

Relationship Between Urban Impact Aid Allocations and Base Revenue Limits
1984-85
(Per ADA)

Amount of UIA Per Pupil	Base Revenue Limit: Low (Less Than $2,031)	Medium ($2,031 to $2,310)	High (Over $2,310)	Totals
$0.00	83.0% (289)	88.1% (312)	92.7% (303)	87.9% (904)
$0.01 to $7.50	4.6 (16)	2.8 (10)	2.8 (9)	3.4 (35)
$7.51 to $15	4.0 (14)	1.7 (6)	1.8 (6)	2.5 (26)
$15.01 to $30	5.2 (18)	3.1 (11)	2.1 (7)	3.5 (36)
Over $30	3.2 (11)	4.2 (15)	0.6 (2)	2.7 (28)
Totals	100.0% (348)	100.0% (354)	100.0% (327)	100.0% (1,029)

Effects on Serrano Compliance. The data in Table 4 suggests that, if UIA allocations were included in general education spending per pupil for purposes of measuring compliance with the court's decision in the Serrano case, equalization might be enhanced. As shown in Table 5,

however, the relationship between the distribution of UIA per pupil and school districts' revenue limits is so slight that treating UIA as general education spending would result in no change in the degree of equalization, using the standard employed by the Superior Court in its 1983 decision.

Table 5

Effect of Urban Impact Aid Allocations
on School Finance Equalization
(Percent of ADA Within Serrano Closure Band[a])
By Category of School District
1984-85

School District Category	Measure of General Education Expenditures: Base Revenue Limit Only	Measure of General Education Expenditures: Base Revenue Limit Plus UIA Per Pupil
Small elementary	77.2%	77.2%
Large elementary	92.4	92.4
Small high school	79.8	79.8[b]
Large high school	87.1	87.1
Small unified	90.4	90.4[b]
Large unified	97.0	97.0
Totals[c]	94.8%	94.8%

a. Width of closure band in 1984-85 is $213.
b. No school districts in this category received UIA in 1984-85.
c. Total ADA within closure band for all six categories, divided by statewide total ADA.

Table 5 compares the percentages of ADA that would be included within the inflation-adjusted Serrano closure band under two alternative measures of general education expenditures per pupil: (1) base revenue limit only and (2) base revenue limit plus UIA per pupil. The table shows

that, for each of the four categories of school district which receive UIA in 1984-85 (small and large elementary, large high school, and large unified), the inclusion of UIA amounts has absolutely no effect on the closure statistics.

CONCLUSION

In summary, our analysis indicates that there is a slight inverse relationship between a school district's revenue limit and the amount of UIA per pupil which it receives in 1984-85. This relationship, however, is so small that it does not reduce disparities in educational spending per pupil, as measured using the standard adopted by the court in the most recent Serrano case. Accordingly, we conclude that the current distribution of UIA neither results in nor appreciably ameliorates wealth-related expenditure disparities among school districts.

CHAPTER III

REASSESSMENT OF THE RATIONALE FOR URBAN IMPACT AID

This chapter examines the rationales behind the UIA program, as Chapter 482 requires. In doing so, however, we are handicapped by the fact that the statute which established the UIA program in 1977--AB 65--did not specify the purpose of UIA. Furthermore, there are no records available which formally document the Legislature's reason for providing UIA.

In conducting this examination, therefore, we found it necessary to use the rationale for the program commonly cited by legislative consultants, program administrators, and recipients: "UIA is intended to compensate school districts for the higher costs associated with providing education in an urban setting." These additional costs might be associated with such things as higher insurance premiums, higher teacher salaries, additional maintenance costs, and a variety of other factors.

In this chapter, we discuss three variations of the "higher-cost" rationale:

1. An urban district's higher costs reflect the higher prices it must pay for the resources and services needed to educate students;

2. An urban district's higher costs result from the need to provide services that other districts need not provide; and

3. An urban district's higher costs are incurred in attempting to equalize educational outcomes.

HIGHER PRICES?

Very little research has been conducted on the extent to which schools in urban areas face higher costs than schools in nonurban areas. In fact, we were able to identify only one in-depth study of this issue--a 1980 study of costs conducted by Dr. J. G. Chambers of Stanford University for the California State Department of Education.

The Chambers Study. Dr. Chambers compared differences in the prices that school districts in different areas of the state must pay for such educational inputs as teachers and school buses.[1] (Dr. Chambers did not consider differences in the amount of funding needed to produce similar educational outcomes.) In doing so, his objective was to develop a cost-of-education index which could be used to measure differences in the price of inputs faced by different districts.

The methodology used by Dr. Chambers is similar to the one used in constructing the consumer price index. Specifically, he assumed that all school districts purchase the same "market basket" of inputs, composed of such things as teachers, secretaries, bus drivers, electricity, etc. (The study focused on school district personnel and energy costs, since these factors account for the bulk of the average school district's expenditures.) For each district, Dr. Chambers estimated (1) the cost of each type of input and (2) an overall "cost-of-education index" (CEI) which was a weighted average of the cost of the various inputs. Individual

1. Jay G. Chambers, The Development of a Cost-of-Education Index for the State of California, Final Report, Institute for Research on Education Finance and Governance, School of Education, Stanford University, 1980.

inputs were weighted according to their significance in the average school district's budget. For instance, since teacher salaries comprise approximately 57 percent of the average school district's budget, 57 percent of each CEI estimate was based on the cost of this factor.

Dr. Chambers's study found that school districts in metropolitan areas tend to have higher costs than their nonmetropolitan counterparts.

UIA and Higher Costs. Assuming that the conclusions from the Chambers study are valid, the next question that must be answered is: does the UIA program distribute funds in a way that accurately compensates urban districts for their higher costs? In order to answer this question, we compared the distribution of UIA funds among the 125 eligible districts in 1984-85 with the cost-of-education index for these districts.

We found that the districts eligible for UIA, on average, tended to have slightly higher costs than did other districts. Specifically, the average value of the cost-of-education index for eligible districts was 1.02, while the average value for all other districts was 0.99. About one fourth of the districts eligible for UIA, however, had index values which were lower than the average values of their noneligible counterparts.

We also found that the manner in which UIA funds were distributed among eligible districts bore virtually no relationship[2] to the districts' relative need for urban impact aid as indicated by the cost-of-education index. Urban Impact Aid, therefore, does not appear to compensate districts accurately for the types of costs measured by this index.

2. Correlation = 0.144.

MORE SERVICES?

Another rationale for UIA advanced by representatives of urban districts is that they face higher costs because they must offer services that are not reflected (or are underweighted) in the Chambers cost-of-education index. These services, they argue, must be provided in order to offer the same "educational environment" as their nonurban counterparts.

For instance, some urban districts have to hire more security guards and purchase more property insurance than most other districts, leaving fewer funds available for instruction. Thus, these districts face higher costs not because of differences in the prices of inputs, but because they must purchase more inputs in order to provide an educational program of a quality equal to that provided by other districts.

Some evidence that urban school districts do incur more of these unique costs is presented in our report, "Excess Cost to School Districts Resulting From Low Income Target Areas" (January 6, 1971). However, districts are not required to report how much they spend each year for "extra" services such as security, insurance, and vandalism repair. As a result, (1) there is no data on the magnitude of these costs statewide and (2) we are unable to determine whether the criteria used in the UIA formula are reasonable proxies for these costs.

Even if we assume that the criteria employed in the UIA formula are reasonable proxies for operating costs, there is no reason to believe that the values for these criteria in 1975-76 are indicative of cost differentials today--fully 10 years later.

Thus, we conclude that if the criteria used in the formula are good indicators of need, UIA allocations should be based on the most recent data available.

EQUALIZING EDUCATIONAL OUTCOMES?

A final, and more ambitious, rationale sometimes given for UIA is that these funds compensate urban districts for the higher operating costs arising from the special needs of disadvantaged students. These students may require compensatory education and other "extra" resources in order to attain levels of educational achievement that are comparable to those of nondisadvantaged students.

There are two problems with attempting to justify UIA on this basis. First, other categorical programs, such as Economic Impact Aid, have been set up and funded for the express purpose of equalizing education outcomes in districts with a large number of disadvantaged students. Second, it is difficult to identify the amount of aid that any individual school district requires in order to equalize average educational outcomes among different categories of students. We therefore are unable to determine whether current allocations of UIA accurately reflect participating districts' needs for additional compensatory education funding beyond the amounts already provided by other categorical programs.

Once again, even if we assume that the criteria employed in the UIA formula are reasonable proxies for equalizing average educational outcomes, there is no reason to believe that the 1975-76 data provides a reliable indicator of relative needs today.

CONCLUSIONS

1. The limited evidence available indicates that school districts in metropolitan areas tend to have higher costs than districts in nonmetropolitan areas. However, about one-fourth of the districts eligible for UIA appear to face lower-than-average costs.

2. Given the data now available, there simply is no way to verify whether those districts that score high under the UIA formula have costs that are correspondingly higher than those faced by nonrecipients. It is therefore impossible to say how well the UIA program targets funds to districts most in need.

3. We can find no evidence that the criteria used in the UIA formula are reasonable proxies for either the "extra services" rationale or the "equalizing educational outcomes" rationale for the program.

4. Even assuming that the criteria employed in the UIA formula are reasonable proxies for these rationales, however, there is no reason to base UIA allocations on the values of these criteria in 1975-76. Thus, if there is any validity to the UIA concept, program funds could be more effectively targeted if current data were used in the allocation formula. Accordingly, we recommend that the Legislature amend the UIA formula to require the use of current data in order to assess funding needs more accurately.

CHAPTER IV

ALTERNATIVE DISTRIBUTIONS OF URBAN IMPACT AID

As noted in the previous chapter, it is not possible to verify that the variables on which the UIA formula relies are good measures of "excess" costs. Even if there is some relationship between these variables and "excess" costs, however, there is simply no reason to base the distribution of UIA on what the values of these variables were 10 years ago. Doing so may allow some districts to qualify for UIA even though they no longer warrant additional support, while other districts with relatively greater needs are denied aid.

In this chapter, we explore alternative means of improving the allocation of funds under the UIA program by utilizing more recent measures of relative need.

CRITERIA FOR EVALUATING ALTERNATIVES

We believe that in choosing a method for allocating UIA, the Legislature should consider the following criteria:

- Does the Method Accurately Reflect Need? The allocation method should, to the maximum extent possible, distribute UIA to districts in direct proportion to their needs. While it may not be possible to measure need precisely, the method used to

calculate need should at least minimize the possibility of gross inaccuracies.

- Does the Method Provide Districts With Sufficient Time to Adjust to Any Loss of Revenues? Any change in the allocation formula, however desirable on equity grounds, would present problems for districts which experience a sudden, major decrease in funding, since these districts would be forced to reduce expenditure levels rapidly. Consequently, changes in UIA allocations should be implemented in such a way as to allow districts a reasonable time to adjust.
- To What Extent Would the New UIA Entitlements Fall Within Existing Funding Levels? In the event a new method for allocating UIA requires large increases in the UIA funding level, it will leave the Legislature with less money for other high-priority purposes. (The 1985 Budget Act provides $75.4 million for UIA in 1985-86.)

APPROACHES FOR INCORPORATING NEW DATA

In a report required by supplemental language to the 1984 Budget Act, the State Department of Education (SDE) identified several alternatives for incorporating new data into the UIA formula[3]. Some of these alternatives involve updating UIA entitlements on a one-time basis. The report suggests that the Education Code could be amended to require entitlements to be based on 1985 data, rather than 1975-76 data.

3. California State Department of Education, "Urban Impact Aid, Allocation of Funds and Alternatives for Reallocation," February 20, 1985.

We believe, however, that it makes more sense for the Legislature to consider alternatives which involve periodic adjustments to UIA entitlements, in order to reflect changing conditions and minimize the changes in funding allocations that are required at any one time. If the Legislature, instead, chooses to update entitlements on a one-time basis, in several years, it will find itself confronting the same situation it faces today--namely, a funding system that is based on outdated information necessitating a major reallocation of funds. We believe that districts would be better served if entitlements were adjusted on a regular basis, rather than on an infrequent and sporadic basis, so that districts will experience fewer major changes in revenues with which they must cope.

Ideally, the UIA entitlements should be updated every year, so that the allocation of UIA funds closely corresponds to the most recent indicators of need. While our analysis indicates that, for most districts, these indicators do not change significantly from one year to the next, in some cases the indicators change dramatically. For instance, the need indicators for the Fresno school district have risen rapidly in the last few years because of an influx of Southeast Asian refugees into the area. A system of annual updates would allow funds to be quickly channeled to districts, like Fresno, whose need indicators suddenly increase.

WHAT CAN BE DONE TO HELP DISTRICTS ADJUST TO REVENUE CHANGES?

Because the distribution of UIA to unified districts has remained unchanged for almost 10 years, the use of more recent data--with no increase in the total allocation of funds for UIA--would cause some school districts to lose substantial amounts of aid. Table 6 illustrates this.

It shows that over half of the unified districts currently receiving aid would experience a decline in aid levels. One of these districts (Berkeley) would lose 100 percent of its UIA. The percentage loss among the others would range from 0.4 percent to 26.5 percent. (The median percentage loss in aid among these districts is 13.7 percent.)

Table 7 simulates how the amount of UIA received by districts would fluctuate from one year to the next under a system of annual updates of entitlements. As the table shows, the median increases in funding levels from one year to the next would range from 3.4 percent to 15.8 percent; the median decreases in funding levels would range from 5.5 percent to 12.6 percent. Furthermore, the table shows that 43 percent of all applicable districts would receive both an increase in funding in one year and a decrease in funding in the other. (This calculation excludes districts that would have been ineligible to receive UIA in any year during the period 1983-84 to 1985-86.) While these annual funding fluctuations are smaller than the changes that would result from the initial update of entitlements, the fluctuations are not insignificant.

Table 6

Urban Impact Aid Allocations for Unified School Districts:
Allocation Comparison Using Statutory and Most Recent Data

School District	Statutory 1984-85 Allocation	Allocation Using Most Recent Data	Increases	Decreases	Percentage Change
Berkeley	$241,229	N/E		$241,229	-100.0%
Oakland	4,255,913	$3,663,077		592,836	-13.9
Richmond	1,090,995	932,854		158,141	-14.5
Fresno	2,217,891	2,857,463	$639,572		+28.8
Baldwin Park	525,069	510,608		14,461	-2.8
Inglewood	703,193	700,073		3,120	-.4
Long Beach	1,760,987	2,534,752	773,765		+43.9
Los Angeles	32,284,566	28,678,093		3,606,473	-11.2
Lynwood	N/E	800,904	800,904		N/A
Montebello	1,602,390	1,565,842		36,548	-2.3
Norwalk-La Mirada	N/E	433,743	433,743		N/A
Pasadena	1,019,949	879,496		140,453	-13.8
Pomona	1,000,362	1,098,863	98,501		+9.8
Compton	3,322,599	2,443,456		879,143	-26.5
Garden Grove	N/E	529,441	529,441		N/A
Santa Ana	793,814	1,021,039	227,225		+28.6
Riverside	N/E	451,221	451,221		N/A
Sacramento	1,763,674	2,453,102	689,428		+39.1
San Bernardino	1,536,752	1,804,478	267,726		+17.4
San Diego	2,178,895	2,970,276	791,381		+36.3
San Francisco	4,580,946	3,955,157		625,789	-13.7
Stockton	1,833,320	2,496,113	662,793		+36.2
San Jose	614,456	546,949		67,507	-11.0
Totals	$63,327,000	$63,327,000	$6,365,700	$6,365,700	

N/E: Not eligible in this year.
N/A: Not applicable (percentage change cannot be calculated).
Source: California State Department of Education.

Table 7

Percentage Change in UIA Allocation
Under a System of Annual Entitlement Updates
(Hypothetical)[a]

School District	1984-85	1985-86
Unified:		
Oakland	2.9%	-8.2%
Richmond	-13.1	-9.0
Fresno	25.1	3.4
Baldwin Park	N/A[b]	1.3
Inglewood	-17.2	9.0
Long Beach	19.1	10.7
Los Angeles	-6.9	-0.8
Montebello	-2.9	-3.4
Pasadena	-15.7	-6.3
Pomona	1.6	3.4
Compton	-14.5	-14.3
Garden Grove	N/A[b]	0.3
Riverside	N/A[b]	-4.3
Santa Ana	29.4	-2.1
Sacramento	14.4	-6.8
San Bernardino	9.5	-3.3
San Diego	11.6	-6.1
San Francisco	-3.3	-13.8
Stockton	-12.6	33.0
San Jose	-5.9	-5.4
Median percentage:		
Increase	13.0%	3.4%
Decrease	12.6%	6.1%
Nonunified:		
Kern	-5.9%	-6.3%
Alhambra	30.3	0.5
Centinella Valley	-2.2	-5.1
El Monte	6.7	-0.5
Whittier	7.2	-1.8
Merced	33.5	31.0
Grant	-8.5	-6.4
Chaffee	7.9	-9.6
Salinas	-100.0	--
Sweetwater	-0.6	-8.9
Eastside	8.1	-7.3
Modesto	3.2	-0.8
Oxnard	-5.1	-6.5
Median percentage:		
Increase	7.9%	15.8%
Decrease	5.5%	6.4%

a. Excludes funds for COLA.
b. N/A: Not applicable (district ineligible for funds in previous year).

What could be done to help school districts adjust to revenue changes? The Legislature could adopt one of four policies toward these districts:

- Allow the funding allocation to be determined annually by the formula--that is, provide no adjustment mechanism;
- Hold districts harmless from a loss of funds;
- Phase-in new entitlements; or
- Reduce fluctuations by averaging entitlements over a multi-year period.

No Adjustment Mechanism. If the Legislature provided no adjustment mechanism, updates based on new data could be implemented immediately, thus tying the allocation of aid closely to the most-recent indicators of need. The drawback to this option is that it is difficult for districts to reduce expenditures significantly from one year to the next.

Hold-Harmless Mechanism. The Legislature could implement a hold-harmless provision, under which no district would lose funds as a result of the new allocation method. Such a hold-harmless provision would be implemented by putting a statutory floor under all current entitlements.

A hold-harmless mechanism also has a significant drawback. It would, in effect, institute a permanent financial subsidy to districts whose need indicators have declined. Furthermore, a hold-harmless provision would require a major budget augmentation every time entitlements were adjusted. The SDE estimates that updating unified school districts' entitlements would initially cost $6.4 million under a hold-harmless provision. Future adjustments would require additional augmentations. We estimate that holding unified districts harmless from the year-to-year

adjustments simulated in Table 7 would have required a $3.6 million augmentation in 1984-85 and an additional $2.3 million augmentation in 1985-86.

The SDE, in its report, also suggested a "modified" hold-harmless provision. This proposal involves: (1) annual updates, (2) holding the total UIA appropriation constant (except for COLA) whenever entitlement adjustments are made, and (3) guaranteeing districts a fixed percentage (for example, 85 percent) of their previous funding levels. This alternative would involve no increase in state costs, and the subsidies to districts with declining levels of need gradually would be reduced.

This alternative, however, has two disadvantages.

First, holding funding reallocations "harmless" by raising the entitlements of some districts leaves less UIA available for distribution to districts with rising levels of need. The proposal would therefore not result in funding allocations that coincided with relative need.

Second, a "modified hold-harmless" provision provides additional funds to districts with declining entitlements much longer than is necessary. In fact, subsidies beyond what can be justified on the basis of need would not be reduced to insignificant levels for 10 to 15 years, and would never be eliminated entirely. Cushioning districts from the impact of revenue loses over such a lengthy period of time appears excessive.

Multi-Year Phase-In. Under this alternative, new entitlements would be phased in over a three-year period. During the first year of the phase-in, one-third of the available funds would be distributed based on new entitlements, and the remaining two-thirds would be allocated in

proportion to the old entitlements. The new entitlements would be used to allocate two-thirds of the funds in the second year of the phase-in, and all of the funds in the third year.

This alternative would allow districts enough time to adjust to new entitlement levels, but does not provide so much time that districts with rising levels of need are deprived of additional funds for a protracted period. The alternative is an attractive way to help districts adjust to the large changes in funding levels associated with an initial update of the UIA entitlements.

As an ongoing approach to helping districts adjust to funding changes, however, the alternative has at least two drawbacks.

First, the system would prevent those districts which experienced a sudden increase in need from quickly obtaining additional funds. Always phasing-in new entitlements over a three-year period would require entitlements to be updated in at least three-year intervals. Consequently, a sudden increase in a district's index of need might not be identified for as many as three years, and it would not receive its total entitlement for another three years.

Second, if a district's need indicators temporarily declined in a year during which entitlements were updated, only to increase in the following year, the district would be unfairly penalized.

Three-Year Moving Average. A fourth approach to helping districts adjust to changes in funding levels would be to allocate aid based on a three-year average of computed entitlement levels. In any given year, the Superintendent of Public Instruction would calculate the district's UIA

entitlement for the current and two preceding years. These computed entitlements would be calculated by using data for each year in the UIA formula. The Superintendent would then average these three computed entitlements in order to obtain a "revised" entitlement upon which actual UIA allocations would be based. (The simplest method of obtaining the revised entitlements would be to average unreduced entitlements and then to prorate available funds.) Allocations would then be recalculated the following year based upon a new three-year average of computed entitlements.

Using a three-year moving average would reduce the degree to which UIA entitlements fluctuate from one year to the next. In conducting our study, we did not have sufficient data to calculate exactly how this approach would affect funding entitlements. Table 8, however, illustrates the effect of averaging districts' "index of need" values. (Changes in these need index values are the primary cause of fluctuations in funding levels.) It shows the index of need values for four selected districts over an eight-year period. The values of the index are based on each district's AFDC count multiplied by its EIA factor, and are presented in the table as percentages of each district's 1977 levels. The table shows that, from year to year, the values of the need index may increase by as much as 22 points (Fresno) or decline by as much as 18 points (Los Angeles).

Table 9 illustrates the effect of averaging the need index over three years. A careful inspection of Table 9 shows that there is considerably less variation in the figures from one year to the next than

in the unaveraged figures presented in Table 8. Specifically, the average change in the index from one year to the next declines from 9.4 to 2.5 (a 73 percent decrease) in the case of Los Angeles, and from 6.9 to 3.7 (a 46 percent decrease) in the case of Baldwin Park.

Table 8

Index of Need
Four Selected Districts
1977-78 to 1984-85

Year	Los Angeles	Baldwin Park	San Francisco	Fresno
1977-78	100	100	100	100
1978-79[a]	103	108	96	97
1979-80	99	96	85	93
1980-81	91	96	74	92
1981-82[a]	104	102	75	109
1982-83	117	109	77	125
1983-84	99	108	75	148
1984-85	106	122	75	170
Average Yearly Change, 1977-78 to 1984-85[b]	9.4	6.9	4.4	12.3

a. EIA data was not obtained for these years. EIA values were therefore constructed for these years by averaging the values for the preceding and succeeding years.
b. Average of the absolute values of the change for each year.

Table 9

Three-Year Moving Average
Index of Need
Four Selected Districts
1979-80 to 1984-85

Year	Los Angeles	Baldwin Park	San Francisco	Fresno
1979-80	100.7	101.3	93.7	96.7
1980-81	97.7	100.0	85.0	94.0
1981-82	98.0	98.0	78.0	98.0
1982-83	104.0	102.3	75.3	108.7
1983-84	106.7	106.3	75.7	127.3
1984-85	107.3	113.0	75.7	147.7
Average Yearly Change, 1979-80 to 1984-85[a]	2.5	3.7	3.8	11.3

a. Average of the absolute value of the change for each year.

Changes in the need index remain large only in the case of the Fresno school district. This anomaly results because all of the large changes in Fresno's index, starting in 1980, are in the same direction; positive and negative fluctuations in the index, therefore, do not "cancel out" when the index values are averaged. Upward trends in the index, as well as downward trends, are not eliminated by the utilization of a moving average. We believe this is a desirable feature of the moving-average method, however, since funding levels would continue to be closely tied to changing levels of need. In Fresno's case, for instance, because the indicators of need are rising rapidly, the district would receive an increase in aid even though entitlements are averaged over three years.

Thus, the moving-average method only dampens annual fluctuations in funding levels; it does not fail to recognize continuing trends in the need for funds.

A moving-average mechanism could also be used to help school districts adjust not only to annual fluctuations but to the large funding changes associated with an initial update of entitlements, as well. Because districts' computed entitlements based on "old" data could be averaged together with computed entitlements based on more recent data, districts that stood to lose funds would have their previous, higher aid levels gradually reduced over a three-year period. The change in funding levels would be similar to those that would occur from the three-year phase-in alternative, except that a moving-average allocation formula would also pick up immediately any changes that occurred in district need indicators during the three years following the initial update.

We believe the moving-average mechanism is as good as a three-year phase-in for purposes of helping districts adjust to new funding levels, and is the best alternative for dealing with fluctuations in funding that result from subsequent, annual updates of the UIA entitlements. We therefore recommend that UIA funding allocations be based on a three-year moving-average of entitlements, with these entitlements annually updated to reflect the most recent data.

WHAT HAPPENS IF A DISTRICT LOSES ELIGIBILITY?

It is possible that, if entitlements are adjusted to reflect current data, some school districts will lose eligibility to receive UIA. Our

analysis indicates that, among unified districts, Lynwood, Norwalk-La Mirada, Garden Grove, and Riverside would gain eligibility, but the Berkeley Unified School District would lose eligibility. Berkeley's entitlement, therefore, would drop from its present level of $241,299 to $0.

A three-year transition period between the old and new entitlement levels would provide districts which lose eligibility with some opportunity to make the necessary adjustments. Since the loss of all funding would create a more serious problem than a reduction in a district's entitlement, we believe a five-year transition period would be more appropriate than a three-year period for districts that lose eligibility for UIA. We therefore recommend that funding for districts which lose eligibility be calculated using a five-year moving average, unless the district regains eligibility.

CONCLUSIONS

We recommend that allocations of UIA be based on: (1) data that is updated annually, (2) a three-year moving average of need indicators, and (3) a five-year average of need indicators for districts that lose eligibility.

Table 10 shows the fiscal effect of these recommendations. If the proposal were implemented in 1985-86, the table indicates how funds would be redistributed over the next three years, assuming no change in the UIA need indicators in 1986-87 and 1987-88. (Only data for unified districts is shown.) As reflected in the table, the increase in costs resulting from the proposal would be only $34,000 in 1985-86 and $66,000 in 1986-87.

(These costs stem from the five-year phase-out of Berkeley.) If nonunified districts are included, the proposal would cost a total of $90,000 in 1985-86 and $178,000 in 1986-87. (Here, the costs are higher because aid provided to the Salinas school district would be phased out over a five-year period.)

Table 10

Proposed Allocation
of Urban Impact Aid
Unified School Districts
1985-86 to 1987-88
(in thousands)

School District	1984-85 (Actual)	1985-86 (Proposed)	1986-87 (Proposed)	1987-88 (Proposed)	Yearly Change	Three-Year Change
Berkeley	$241	$193	$145	$97	-$48	-$144
Oakland	4,256	4,058	3,861	3,663	-198	-593
Richmond	1,091	1,038	986	933	-53	-158
Fresno	2,218	2,431	2,645	2,858	+213	+640
Baldwin Park	525	520	516	511	-5	-14
Inglewood	703	702	701	700	-1	-3
Long Beach	1,761	2,019	2,277	2,535	+258	+774
Los Angeles	32,285	31,083	29,880	28,678	-1,202	-3,607
Lynwood	NE[a]	267	534	801	+267	+801
Montebello	1,602	1,590	1,578	1,566	-12	-36
Norwalk-La Mirada	NE[a]	145	289	434	+144	+434
Pasadena	1,020	973	927	880	-47	-140
Pomona	1,000	1,033	1,066	1,099	+33	+99
Compton	3,323	3,030	2,737	2,444	-293	-879
Garden Grove	NE[a]	176	353	529	+176	+529
Santa Ana	794	870	945	1,021	+76	+227
Riverside	NE[a]	150	301	451	+150	+451
Sacramento	1,764	1,994	2,223	2,453	+230	+689
San Bernardino	1,537	1,626	1,716	1,805	+89	+268
San Diego	2,179	2,443	2,706	2,970	+264	+791
San Francisco	4,581	4,372	4,164	3,955	-209	-626
Stockton	1,833	2,054	2,275	2,496	+221	+663
San Jose	615	592	570	547	-23	-68
Total Funding[b,c]	$63,327	$63,361	$63,393	$63,426		
Cost (increase over 1984-85)		$34	$66	$99		

a. Not eligible.
b. Excludes funding to provide a cost-of-living increase.
c. Columns do not total to these amounts exactly because of rounding error.

In conclusion, our analysis indicates that this method of allocating UIA strikes a reasonable balance among the competing criteria. Specifically, funding allocations would be sensitive to districts' indicators of need, but no district would experience a dramatic loss of funding in any one year.