

State of Ohio
The Executive Budget
Fiscal Years 2012 and 2013

The Jobs Budget

Transforming Ohio for Growth

Governor John R. Kasich



Book Five:
The Reforms Book

THE JOBS BUDGET

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Governor John Kasich's Executive Budget – The Jobs Budget – proposes significant, long-overdue transformations of major programs and redefines the relationship between state and local government to preserve essential funding to key programs, while giving local governments powerful new tools to control their costs.

The singular focus of the Governor's budget and its reforms is to help Ohio regain its economic competitiveness and become a place where business can thrive and jobs can grow. This volume provides an expanded analysis of five key reforms.

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March 29, 2011

Note: this document was revised on April 8 to correct a formatting error and duplicate page.

Education That Gets Results: Giving Taxpayers Their Money's Worth

Budgets are about more than money. Budgets express an administration's priorities.

The educational priorities of this budget are clear...achieving student results while giving districts the tools to control costs. They turn away from old, expensive and ineffective practices that are robbing our children of the opportunity to get a great education. They align Ohio practices to the practices that create successful schools. These changes will improve education while cutting costs that don't relate to student results.

Today's Educational Realities

Education is the key to personal prosperity, and our state's long-term success. Education does not operate in a vacuum and must respond to an ever-changing world that includes the following:

- A globally competitive marketplace. Our children will compete globally for jobs and economic prosperity.
- Rising expectations for knowledge and skills. Advanced learning is the new normal for today's jobs. A good high school education is not sufficient to prepare young people for competitive jobs in today's economy. Blue collar jobs require knowledge and skills that exceed our traditional expectations for entering college.
- Urgency for all students to succeed. If Ohio is to become competitive nationally and internationally, we must greatly increase the number of students who succeed.

What We Know About Schools That Succeed

A high-performing, cost effective educational system is achievable. Real schools serving real students in really tough environments are already showing results. They are beating the odds and proving success is possible. Here are some of the hallmarks of these schools:

Results – Everyone at the school knows where they stand on student results as compared to their peers. Moreover, results at these schools are benchmarked against high-performing schools, and not schools that let them look good.

Responsibility – Within every high-performing school, the adults take responsibility for student success. They refuse to participate in the practice of blaming poverty, parents, and poor support for student results. They work on what they control and solve problems one child at a time. This sense of responsibility by the educators inspires students, parents and community members to also take responsibility for student results.

Students – Students and their success become the focus of daily work. Contracts, reforms, communications, school design, and all other decisions are driven by a simple question...Will this improve student success?

Choice – High-performing schools embrace choice and see it as a catalyst for making a difference for children. They recognize that when adults compete for the right to educate our children, the children win.

Flexibility – High-performing schools have been successful despite being unnecessarily burdened by rules and regulations that too often raise barriers to creativity and problem solving. All that matters is student success. Flexibility to offer student-centered educational experiences is required and pursued.

Technology – Technology is often added to existing school structures like butter onto toast. Simply installing computers isn't enough. Students truly benefit only when technology and technology-based instruction are integrated into every aspect of the school experience. Schools that do this capitalize on the capacity of today's students, who are digital natives, to learn in a technology-rich environment.

Budget Provisions

Governor Kasich's Executive Budget increases State K-12 education funding to schools in each year of the biennium (1.4 percent and 1.5 percent respectively¹). A transition funding formula is provided for the first year of the biennium. This transition formula directs more funds to poorer districts, as defined by local property wealth per pupil. A student-focused, results-driven funding formula will be developed and submitted to the General Assembly within a year of budget approval.

Funds allocated to state and regional entities are being adjusted to:

- Fund students, not bureaucracies
- Fund the most successful and flexible programs possible
- Assure critical investments in performance tracking systems.

Federal maintenance of effort provisions are met for special education and career-technical education, ensuring continued funding of specific federal programs.

In the previous biennium, many districts used federal stimulus funds for ongoing operations even though policymakers knew these funds were one-time money that would not be available in the future. Schools that relied on stimulus money to continue to operate or even expand their

¹ Office of Budget and Management, Executive Budget Proposal, <http://obm.ohio.gov/sectionpages/Budget/FY1213/ExecutiveBudget.aspx>; p. D-186.

programs are going to have the hardest time coping with the budget moving forward. Schools that used stimulus dollars to reform their operations will be in much better shape going forward.

We are providing all school districts with the tools to adapt to the current and future budget landscape while continuing their efforts to improve student results. These reforms are integral to achieving the goals and priorities of the budget.

THE NEEDED REFORMS WE WILL IMPLEMENT

The reforms we will implement are aligned to what successful schools require. These reforms will allow great teachers, principals, superintendents, and school boards to ensure student results. The Governor's reform agenda will move Ohio from being a manager of the educational status quo to becoming a model that other states will emulate.

Put Superior Teachers in Every Classroom, Excellent Principals in Every School

We will make Ohio the preferred destination for creative, talented educators including Teach for America.

Reward Superior Educators

What will change

Pay teachers a per-student bonus for every student in a class which achieves more than one year growth as measured by the value-added dimension of the local report cards.

Why this change is important

Teachers who are helping students gain more than a year's growth in a year deserve to be rewarded.

Eliminate Licensure Provisions That Unnecessarily Restrict Quality Candidates

What will change

Restrictive licensure procedures will be eliminated to allow individuals with expertise and passion, but who have not pursued traditional teacher education programming, to teach in our classrooms and lead our schools. These changes will bring organizations like Teach for America to Ohio. They will also allow great teachers who want to live and work in Ohio to be licensed to teach here.

Why this change is important

Great teachers come from many walks of life. Research shows teachers from alternative licensure routes are as good as or better than traditionally prepared teachers.² And because our historic licensure requirements are not tied to student results, they are a poor proxy for teacher quality.

Teach for America (TFA) recruits the top students from major universities around the country to work in urban schools. They have very high standards for academic success and commitment from members. The program provides intensive, student-centered training for candidates prior to putting them in the classroom. Once TFA members are placed in the classroom, Teach for America provides ongoing onsite and group support to the first-year teachers. Teach for America has a strong track record of improving student results in hard to serve environments like poor urban schools. Thirty-one states and the District of Columbia currently welcome Teach for America members.

Individuals testifying before the House Education Committee in February, 2011 indicated they were unable to get licensed in Ohio even though they were highly successful teachers in other states. These individuals were all from Ohio and wanted to return to the Buckeye State, but the current licensure process discouraged them from doing so.

These provisions do not require schools to hire specific people; they only provide schools with an additional pool of high quality candidates.

Eliminate Seniority (Last in, First out) As the Basis of Employment Decisions

What will change

Employment decisions will be based on teacher quality, not seniority. Teacher quality will be determined by evaluations and licensure.

Why this change is important

Seniority-based layoffs ignore the fact that novice teachers are not always the least effective teachers. Teachers of all levels of effectiveness lose their jobs; 80 percent of those cut are better than the lowest performers who continue teaching. Statistically, only 13-16 percent of the teachers laid off in a seniority-based system would also have been cut under an effectiveness-based system.³

²Kane, T.J., Rockoff, J.E., and Staiger, D.O. (2006). *What Does Certification Tell Us About Teacher Effectiveness? Evidence from New York City*. (NBER Working Paper 12155). Cambridge, MA: National Bureau of Economic Research.
http://rsss.anu.edu.au/themes/TQConf_Rockoff.pdf

³Boyd, Donald; Hamilton Lankford, Susanna Loeb, and James H. Wycoff, 2010. "Teacher Layoffs: An Empirical Illustration of Seniority vs. Measures of Effectiveness." CALDER Brief 12. Washington, DC: The Urban Institute.

Up to three and a half months of learning can be lost per year because superior teachers are lost in a seniority-based system.⁴

Ohio is only one of 14 states that still require seniority as the basis for employment decisions. Eight states and the District of Columbia have either passed or are considering passage of legislation requiring performance to be a major factor in employment decisions.

Michael Bloomberg, the mayor of New York City, said, "It's time for us to end the 'last-in, first-out' layoff policy that puts children at risk here in New York – and across our wonderful country."⁵

Test Teachers in Poor-Performing Schools

What will change

Teachers employed in a school identified in the bottom five percent of the state's schools on the basis of student results will be required to take licensure tests.

Why this change is important

Massachusetts successfully implemented a teacher-testing program that significantly improved student results. Teachers were tested on the content they were assigned to teach.

Struggling schools need to be sure teachers are competent and fully capable of teaching their assigned curriculum. Testing teachers to be sure they know their content and basic pedagogy is a key step in this process.

Testing will make sure teachers are competent in the subjects they are teaching. Limiting this provision to poor-performing schools will minimize costs and avoid unnecessary burdens on quality schools.

Streamline Dismissal Processes for Poor-Performing Educators

What will change

School employees will have their termination hearing held before the board of education.

Employees can choose to appeal a board of education's termination decision to either the common pleas court or through the grievance process, but not both.

Why this change is important

This will eliminate the common practice of moving poor-performing teachers around in school districts. The practice is so common that it has been labeled the "Dance of the Lemons."

⁴ Goldhaber, Dan, and Michael Hansen, 2010. "Using Performance on the Job to Inform Teacher Tenure Decision. CALDER Brief 10. Washington, DC: The Urban Institute.

⁵ Gotham Schools blog, September 27, 2010)

There have been a number of examples when taxpayers paid hundreds of thousands of dollars in order to terminate a teacher who defied school rules and failed to teach the curriculum assigned. This is a tremendous financial burden for school districts, especially when the case against the teacher is clear. Although the district might eventually prevail, precious educational resources are lost.

Support Innovative, Successful Schools and Close Failing Schools

We can no longer trap Ohio's children in chronically failing schools.

Rank Schools on the Basis of Student Results

What will change

The Ohio Department of Education will be required to rank schools within comparable groupings on the basis of student results and cost effectiveness. They will use data currently collected from schools. The rankings will be readily available to the public, especially parents.

Why this change is important

Ranking is part of accepting responsibility. Rankings provide a more transparent picture of student results and financial efficiency than our current report card rating system. In the current system, a school can be recognized as Excellent with Distinction while having nearly one in five students fail. Ninety excellent-rated districts had ACT scores below the state average. One excellent-rated district had a college remediation rate of 81 percent. Sixty-five excellent-rated school districts had negative value added scores.⁶ Clearly, excellence doesn't mean high student results in Ohio.

Rankings provide opportunities for high-performing schools to be recognized and poor-performing schools to receive the attention they need to improve or be replaced. Rankings also encourage all schools to focus on student results and cost effectiveness. Ranking schools so top performers are evident will allow us to, in Bill Gates' words, "...spread the practices that make them great—it would have an enormous impact on the entire system." According to Gates, "...we haven't tapped into the dynamic of 'everybody learns from the best and gets better.'"⁷

Schools that make dramatic improvements in student results always begin with the realization they were not serving students well. They begin with comparing their performance with the high-performing schools in their region, state, and nation. Their reform efforts are easier to undertake because they are aware of their standing in the education marketplace.

⁶ Ohio Department of Education

⁷ Gates, B. (2011, February 28). *Preparing to Succeed in a Global Economy*. Presentation at the National Governors Association, Washington, DC.

Parents deserve to know where their schools stand on student results. They also need to be able to make informed choices when seeking better schools for their children.

Ohio has an incredible resource in student growth data. This information shows which schools and which teachers are helping students learn a year's worth of material in a year's time. Great teachers should be paid more. Student growth data recognizes teachers who work with students who may be struggling as they enter a school or class, but gain substantially during the year. It fairly recognizes teachers and schools for the value they add to children's educational experience.

Florida and Michigan currently rank their schools. Michigan uses these rankings in their school accreditation process.

Schools vary significantly in how efficiently they operate. According to a report from KnowledgeWorks, if Ohio's schools were as efficient as the best schools, they could save up to \$1.4 billion a year in non-instructional costs.

Create a Recognition Program Based on Student Results

What will change

The Governor's School Recognition Program will be established to recognize schools that are rated in the top ten percent among Ohio schools in student results and cost effectiveness.

Why this change is important

Schools that are performing well should be recognized for their efforts. They should be held up as exemplars of what is possible and as places where aspiring high performers can find best practices.

Create Innovation Schools and Innovation School Zones

What will change

Schools will be given the opportunity to be identified as innovation schools. These schools will be given the authority to waive certain school district policies and procedures, collective bargaining agreement provisions, and state rules and regulations except for narrowly defined exceptions such as services for disabled or gifted students. Multiple schools can join together to create an innovation school zone.

The creation of an innovation school or school zone will only be possible if at least 50 percent (60 percent, if collective bargaining provisions are to be waived) of the teachers and 50 percent of the administrators at the school or schools agree to do so. The school staff must present an innovation plan to the school board. The school board will be required to accept the plan except for very narrow reasons, which may be presented to the State Board of Education for approval.

Provisions are made for the school board to monitor student results and cost effectiveness. If the school or schools fail to meet performance expectations, the innovation standing can be revoked.

Why this change is important

Quality schools require highly engaged teachers and principals. Engagement begins when these professionals take responsibility for student results and seek flexibility to meet student needs. The innovation designation affords the school staff the opportunity to take charge of their own programs, hiring processes, compensation, and other education decisions.

The concept of innovation schools and zones has provided Colorado schools with creative models for meeting student needs and creating student results.

According to Eric Hanushek, a renowned educational researcher, one of the most important factors in improved student results is empowering local decision making.⁸

Give Parents the Right to Reconstitute Their Children's School

What will change

Parents will be given the authority to force a school district to reconstitute a poor-performing school (defined as a school that is in the bottom five percent in student results in Ohio as evidenced by their Local Report Card performance index) using one of the following methods: 1) reopen the school as a community school; 2) replace at least 70 percent of the staff at the school; 3) contract with an entity with a track record of effectiveness in operating schools; or 4) other major restructuring that makes major changes in school staffing or governance. At least 50 percent of the parents of students attending the school must sign a petition to request one of these reforms. Provisions allow the district board to reject the request when it finds the request is for reasons other than improving student academic achievement or student safety or to propose an alternative plan to the State Board of Education.

Why this change is important

Parents should have the right to force major reforms on schools that are failing their children. These failures often result in unsafe environments as well. They should not be forced to leave their neighborhoods or transport their children to other schools when a district does not maintain a high-quality school.

This model has been implemented in California with strong support from parents and a bi-partisan group of political leaders. Parents in Compton, California, are currently exercising their right under this new bi-partisan legislation. This action was taken after an external "district assistance intervention team" indicated the district demonstrated a "lack of a sense of urgency related to student achievement." Colorado is considering similar legislation.

Parental authority made possible by this change is limited to chronically poor-performing schools, which gives a school district ample opportunity to restructure the school on its own.

⁸ Hanushek, E. (2001, March 10). Testimony given at the Senate Education Committee and the House Education Committee. Columbus, OH.

This provision provides even more encouragement to school districts to eliminate poor-performing schools.

Revoke the Charter of the Poorest Performing Schools

What will change

The Ohio Department of Education will be allowed to revoke the charter of any school that remains in the bottom five percent of all schools based on student results for three years in a row. An appeal provision will be provided to the school.

Why this change is important

The Department of Education already has the authority to close chronically poor-performing community schools. This provision would expand the provision to all public schools.

According to U.S. Secretary of Education Arne Duncan, “Children cannot wait for an education. They can’t take a year or two off while administrators tinker around the edges.” Continued support of chronically failing schools is a grievous injustice to children and parents. These schools damage children’s lives, stunt economic growth within communities, and waste precious education resources. They also interfere with opportunities to open more effective schools within the community.

With the three-year provision, districts have time to implement their own restructuring to improve chronically failing schools. This provision provides an aggressive incentive to make meaningful change. An appeal process is provided to assure the schools targeted by this provision are genuinely failing students.

Invest in Students, Not Bureaucracies

Ohio ranks ninth in administrative costs and 47th in funding that gets to the classroom.⁹

If every school in Ohio was as efficient as the best schools, we could save as much as \$1.4 billion in non-instructional costs.¹⁰

Encourage Shared Services to Reduce Non-Instructional Costs

What will change

Shared services, such as human resources, IT, and purchasing occur when government entities work together to provide better services or to drive down costs. Ohio statutes that inhibit government entities from working together to cut costs will be eliminated. It is envisioned that

⁹ Brachman, L, Bradley, J, and Katz B. *Restoring Prosperity: Preparing Ohio's Communities for the Next Economy*. (2010). Greater Ohio Policy Center and the Brookings Institution Metropolitan Policy Program.

¹⁰ Benson, A, and Brinker J. (2010). *Benchmarking Ohio's School Districts: Identifying districts that did not get more for their money in non-instructional spending*. Ohio Smart Schools.

Regional Shared Services Centers will be created by merging the various regional education service providers. These centers will be given the authority to work with local government entities as well as school district. A plan will be developed over the next year and the new system will be in place beginning July 1, 2012.

Why this change is important

In education there are significant opportunities for shared services. There are currently about seven types of regional support groups working with schools. It's time to simplify, clarify and coordinate better.

Current budget challenges will require all government entities including schools to seek more cost-effective ways to provide services. Giving them authority to collaborate and share services will provide better services at a lower cost.

Repeal the Evidence-Based Model for Funding

What will change

All provisions related to the implementation of the Evidenced-Based Model (EBM) for funding, including the unfunded mandates, will be eliminated.

Why this change is important

The EBM funds standardized inputs such as number of teachers, administrators, and support employees. It creates mandates instead of giving flexibility to teachers and principals. It assumes that standard costs are inevitable and does not account for creative new approaches to education, such as blended learning, that can create high student results while spending less.

The EBM approach to educational funding has not achieved the promised student performance gains. These results never materialized, even though funding went up.

The EBM funding approach directs resources to educational structures such as schools and districts, not to student results. It encourages the continuation of standardized, Industrial Age educational models designed around bureaucracies.

Report Financial Data to Identify Highly Efficient Schools

What will change

Expenditure data is collected by the Ohio Department of Education, but is not generally used to identify schools that are efficient or that expend significant resources where it counts, in the classroom. Under this reform, the Ohio Department of Education will be required to create easy to understand, transparent reports on how much each school spends on student instruction. Schools will be grouped by student enrollment size, and comparisons within these groups will be provided. These results will be required to be prominently reported. Provisions for acknowledging the highest performing and the lowest cost schools are provided.

Why this change is important

Ohio's schools need to become more effective at putting limited resources into the instructional activities. Reports show that many districts have seen declines in enrollment and teacher employment while the ranks of the non-instructional staff continued to grow.

Principals and teachers need greater control over the use of financial resources. Prominently reporting the percentage of expenditures getting to student instruction is the first step in making this possible.

Among the major city school districts, while enrollment has declined, staffing has increased. This is especially troubling when student enrollments and teacher positions have declined while non-instructional personnel increases.¹¹ Clearly, there needs to be greater transparency for financial data. High-performing or very cost-effective schools will be recognized for their exceptional efforts.

Expand School Choice

When adults compete for the right to educate our children, children win.

Double Scholarship Availability

What will change

The EdChoice scholarship program will be increased from 14,000 to 30,000 scholarships in the first year and 60,000 scholarships in the second year of the biennium. In addition to public schools in academic watch and academic emergency, student in schools in the bottom five percent of performance as measured by the performance index indicator on the local report card will be eligible for vouchers.

Why this change is important

The EdChoice program has been very successful. The EdChoice program has been available to students enrolled in public schools within districts rated as being in academic watch or academic emergency for two of the last three years. The program has grown from 6,685 students in FY 2008 to 13,021 in FY 2011. The maximum values of the scholarships are \$4,250 for elementary students and \$5,000 for high school students.

These programs do not increase the cost to the state. Instead, they move money to schools supported by parents.

¹¹ Ohio Department of Education

Remove the Cap on Community Schools

What will change

The limit on the number of community schools will be removed. Poor-performing sponsors will not be allowed to open new community schools.

Why this change is important

Community schools continue to provide quality alternatives to existing schools. The current cap on the number of community schools that can operate in the state limits parents' choices and limit quality school options.

The removal of the cap and an aggressive stance on closing poor-performing community schools will assure a more robust school environment focused on student results and cost effectiveness, and create a continuing atmosphere for school improvement. Ohio's role should be to support quality schools, regardless of their governance structure. These provisions will assure every effort is being made to provide quality schools to every child.

Sixteen states have no cap on community schools including Minnesota which has been recognized for having the best community schools in America.

Eliminate the Transfer of a District Collective Bargaining Agreement to a Conversion School

What will change

Community schools created from existing schools using the conversion process historically have required the district collective bargaining agreement to remain in force at the new community schools. This provision would eliminate this requirement and provide the employees at the newly created community schools with the option to join a bargaining unit.

Why this change is important

Community schools were designed to provide an innovative environment for teachers and principals. The automatic application of a district collective bargaining agreement can limit this innovative environment. Providing the teachers in the newly created school the option to create a bargaining unit and to negotiate a unique collective bargaining agreement will assure maximum flexibility.

Enhance Community School Access to Facilities

What will change

School districts currently must give community schools the opportunity to purchase school facilities before they are sold for other purposes. This requirement is extended to school facilities that are being leased.

Why this change is important

Community schools have no access to public funding for facilities. Facilities are a major issue for expanding successful schools. School districts have been reluctant to give community

schools the opportunity to purchase or lease facilities from them. This provision will correct this problem and, in turn, enhance the opportunity for strong school choice.

Provide a Superior Marketplace for Technology-Based Educational Innovations

Today's schools limit the use of the very technology our children will need to master to be successful in the global economy.

Create a Digital-Friendly Marketplace

What will change

eTech Ohio will be required to negotiate statewide pricing on courses and, in turn, pass savings onto schools in FY2012.

Arbitrary restrictions on the use and availability of digital learning options set by collective bargaining agreements, school boards, or administrations will be prohibited. Student and parent rights regarding digital learning and competency-based credit earning is clarified.

A Digital Learning Taskforce will be established to recommend changes that will simplify the state's complicated digital learning bureaucracy and establish a free innovative system that will help deliver more digital instruction to schools more cost-effectively.

Why this change is important

So far, technology has hardly changed the formal education system and students have not been encouraged to take advantage of programs that are available. For example, Carnegie Mellon University's Open Learning Initiative creates college-level online and blended courses. Initial evaluations have found that students in these courses can learn a semester's worth of material in half the time.

Ohio's laws and rules still have vestiges of traditional, low-tech approaches to education that inhibit the use of innovative instructional technology. These must be removed if emerging educational approaches such as blended learning are to thrive in Ohio.

In addition, Ohio has too many boards, organizations, oversight bodies, and monopoly technology providers to be attractive for innovative digital providers that wish to do business here. Ohio has not developed the infrastructure needed to support schools wishing to use technology fully. Other states, such as Florida and Michigan, have been more strategic in their approach to educational technology.

Digital learning is rapidly becoming the norm in private business and top universities such as MIT. However, many schools have negotiated away or established restrictions on the use of digital learning for their students. School administrations have been less than aggressive about

informing parents and students of their rights to earn credit in digital and other competency-based instructional models. These provisions would correct these challenges.

Special emphasis will be placed on making technology-based instruction widely available. Large numbers of Ohio children will master coursework ahead of schedule with this resource, improving both student outcomes and the time available for teachers to work with children who have more difficulty mastering their courses.

Make College More Affordable

Lifelong learning is critical in a knowledge economy.

Create Charter Universities

What will change

The Chancellor of the Board of Regents will submit a report to the General Assembly and the Governor containing findings and recommendations for developing the appropriate policy, administrative rule, and statutory changes necessary to implement a charter university program. The plan will define the manner in which an institution of higher education can become eligible for additional financial and operational authority and will include the performance measures and criteria to be used in determining eligibility requirements.

Why this change is important

Ohio's institutions of higher education must become even more productive and efficient. This provision will provide them with a clear performance expectation while granting them increased autonomy in how they operate to achieve these performance expectations.

Reduce the Higher Education Remediation Rate

What will change

The Board of Regents will be required to report the remediation rate and cost for each school district based on graduates from each school. The Board of Regents will work with the institutions of higher learning to create a clear, actionable definition of what is meant by remediation-free. This definition will explain remediation-free in such a way that school districts can determine the coursework and special programs required to assure every student is college-ready. The Chancellor and the State Superintendent of Public Instruction will produce a set of recommendations to reduce these remediation costs by 50 percent.

Why this change is important

College remediation costs are crippling our ability to provide advanced learning and they are consuming too much of the resources available to students who need financial assistance to attend college. These costs must be reduced.

School districts are charged with preparing students to be college and career-ready. They are responsible for making sure students get the courses and services they need to be ready for college without remediation. Districts cannot determine the courses and services they need unless they have a clear understanding of what is meant to be college-ready.

The remediation issue is a transition issue between high schools and institutions of higher learning. The Chancellor and the State Superintendent must work together to resolve this state challenge.

Encourage Three-Year Degrees at Colleges and Universities

What will change

Universities will be required to produce plans on how to move to three-year baccalaureate degrees. The plan to transition ten percent of their programs will be due in 2012 and a plan to transition 60 percent of their programs will be due in 2014.

Why this change is important

The traditional four-year degree program has become a five- or six-year degree program in reality. Lengthening the time to completion increased higher education costs for the state and families. It also lengthens the time students require to enter new, higher paying employment. Finally, it discourages completion because of the extra years it takes to gain a degree.

Increasingly, high school students are coming to their first year of college with college credit earned from Advanced Placement and International Baccalaureate courses, post-secondary enrollment options credits, dual enrollment, and other innovative high school programs. These credits should reduce the time to degree once these students get to the college campus. Technological advancements are reducing the time required to achieve high school coursework. These same advancements should assist universities with reducing the time required to earn a degree.

Promote Faculty Teaching

What will change

Ohio public colleges and universities will be encouraged to increase full-time research and instructional faculty teaching loads by one class in each of the two years of the biennium. The Board of Regents will report the instructional workloads of faculty for all colleges and universities for FY2010 through FY2013.

Why this change is important

Increasing faculty teaching workloads will increase Ohio's higher education class capacities without increasing costs.

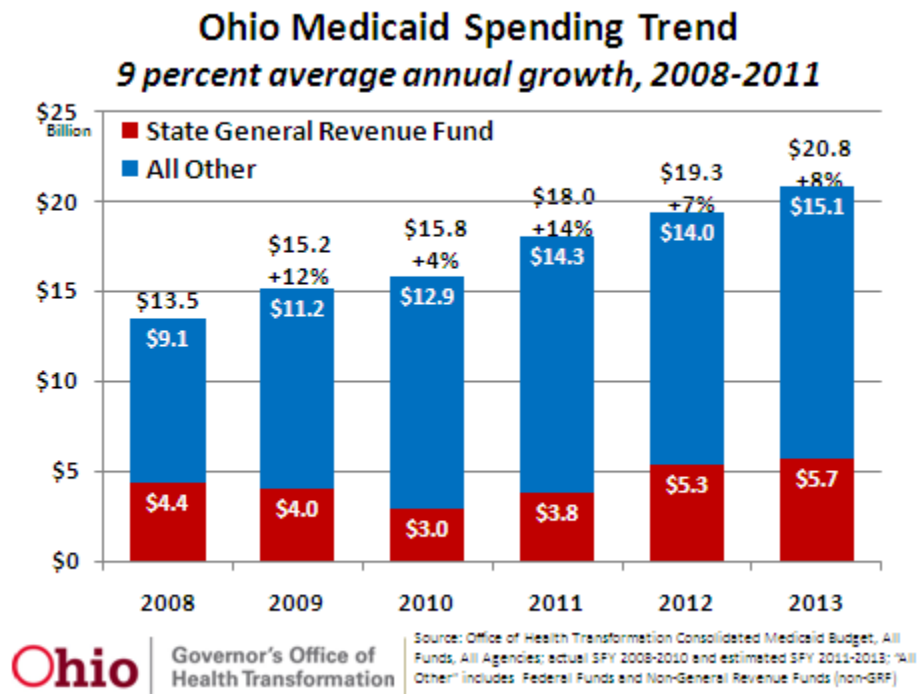
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Medicaid Transformation

Medicaid represents a large and growing share of budgets in six Ohio departments. Past budgets illustrated Medicaid spending by agency, but not a statewide total. As a result, most estimates of Medicaid spending understate the full impact of the program. This analysis focuses on total statewide Medicaid spending, which was \$15.8 billion in fiscal year 2010 (Table 1).

Medicaid now accounts for 30 percent of total state government spending and 4 percent of Ohio’s economy. If we do nothing, Medicaid spending will increase 31.6 percent over the next three years to \$20.8 billion in fiscal year 2013. The current rate of growth is unsustainable and threatens to crowd out other state budget and policy priorities.

Table 1



Governor’s Office of Health Transformation

On January 13, 2011, Governor John Kasich created the Office of Health Transformation to immediately address Medicaid spending issues, plan for the long-term efficient administration of the Ohio Medicaid program, and act to improve overall health system performance (Executive Order [2011-02K](#)). The new office quickly organized existing staff in all of the Medicaid-related agencies to advance the Administration’s Medicaid modernization and cost-containment

priorities in the operating budget. The goal is not incremental but transformational change – aiming higher to achieve better health, better care, and cost savings through improvement.

Budget Impact

The Executive Budget achieves an unprecedented level of Medicaid savings and cost containment – \$4.3 billion over the biennium (Table 2). It maximizes savings in the General Revenue Fund (GRF), resulting in a remarkable 83 percent of net savings (\$1.2 billion) accruing to the state (Table 3). This outcome is critically important to avoid a one-time 42.8 percent (\$1.6 billion) increase in GRF that otherwise would have occurred as a result of Ohio needing to backfill enhanced federal match that is due to expire June 30, 2011. The impact of the expiring federal funds is still significant, but manageable as a result of decisions made in the Executive Budget.

Table 2

All Funds	FISCAL YEAR 2011	FISCAL YEAR 2012	%	FISCAL YEAR 2013	%	FISCAL YEAR 2012-2013
Initial Trend	\$18,020,279,696	\$19,342,184,313	7.3%	\$20,796,914,822	7.5%	\$40,139,099,135
<i>Revised Baseline</i>	\$ (157,440,366)	\$ (379,813,566)		\$ (454,545,028)		\$ (834,358,593)
<i>Additional Costs</i>		\$ 959,811,555		\$ 1,849,269,574		\$ 2,809,081,129
<i>Franchise Fee Revenue</i>		\$ 449,395,358		\$ 438,657,744		\$ 888,053,102
<i>Savings and Cost Avoidance</i>		\$ (1,526,660,553)		\$ (2,775,230,114)		\$ (4,301,890,667)
<i>Subtotal</i>		\$ (497,267,206)		\$ (941,847,823)		\$ (1,439,115,029)
Budget	\$17,862,839,330	\$18,844,917,107	5.5%	\$19,855,066,999	5.4%	\$38,699,984,106

Revised Baseline updated February 28, 2011; includes all departments; does not include Medicare Part D

Table 3

GRF State	FISCAL YEAR 2011	FISCAL YEAR 2012	%	FISCAL YEAR 2013	%	FISCAL YEAR 2012-2013
Initial Trend	\$ 3,737,265,147	\$ 5,335,729,055	42.8%	\$ 5,680,339,444	6.5%	\$ 11,016,068,499
Revised Baseline	\$ 18,240,342	\$ (82,727,222)		\$ (103,091,587)		\$ (185,818,809)
Additional Costs		\$ 343,728,971		\$ 649,428,780		\$ 993,157,751
Franchise Fee Revenue		\$ 161,602,571		\$ 157,258,801		\$ 318,861,372
Savings and Cost Avoidance		\$ (944,873,117)		\$ (1,376,702,881)		\$ (2,321,575,998)
Subtotal		\$ (522,268,797)		\$ (673,106,887)		\$ (1,195,375,684)
Budget	\$ 3,755,505,489	\$ 4,813,460,258	28.2%	\$ 5,007,232,557	4.0%	\$ 9,820,692,815

Revised Baseline updated February 28, 2011; includes all departments; does not include Medicare Part D

Transformation Priorities

This Medicaid budget is challenging, but fair. It includes an aggressive package of Medicaid reforms developed by the Governor's Office of Health Transformation. It aligns policy and funding priorities across all Medicaid-related agencies to:

- Improve care coordination;
- Integrate behavioral and physical health care;
- Rebalance long-term care; and,
- Modernize reimbursement.

These priorities leverage Medicaid to act on opportunities to keep people as healthy as possible instead of reacting only after they get sick, to prevent chronic disease whenever possible and, when it does occur, coordinate care to improve quality of life and reduce costs. They shake loose the status quo and create win-win opportunities for Medicaid enrollees (better services) and Ohio taxpayers (better value). Each priority is described in more detail below.

Improve Care Coordination

The Executive Budget builds on a February 2011 [proposal](#) submitted by the Governor's Office of Health Transformation to the federal Center for Medicare and Medicaid Innovation for a planning grant to improve care coordination. It focuses first on Medicaid enrollees with long-term care needs. For most of these individuals, long-term care, behavioral health, and physical health services are provided through separate delivery systems with little or no coordination. While only seven percent of the Medicaid recipients use long-term care services, 41 percent of annual Medicaid expenditures are for services to this population.

The vision is to create a person-centered care management approach – not a provider, program, or payer approach – that reflects the following core values:

- Individuals receive person-centered care through a delivery system designed to address all of the individual's physical health, behavioral health, long-term care, and social needs;
- Individuals have access to the services they need in the setting they choose;
- The delivery system is easy to navigate for both the individuals receiving services and the providers delivering the services;
- Individuals transition seamlessly among settings and programs as needs change; and
- Incentives in the system focus on performance outcomes related to better health, better care, and cost savings through improvement.

To achieve this vision, the planning grant outlines an implementation strategy for a new Individual-Centered Integrated Care Delivery System (ICDS) that will:

- Focus first on Ohio's 113,000 dually eligible individuals who are residents of nursing facilities, enrollees in Ohio's home and community based services waivers who require a nursing facility level of care, and individuals with severe and persistent mental illness;
- Explore alternative models for implementation, including managed care plans, accountable care organizations, health homes, and/or other integrated care models;
- Require providers to have one point of contact for an individual receiving services;
- Require providers to pursue the triple quality aim of improving the experience of care, enhancing the health of populations, and reducing costs through improvement; and,
- Develop innovative rate-setting methods, including outcome-based performance incentives and focused care coordination.

The ICDS program will be implemented in September 2012. One of the first steps toward implementation will be to seek federal waivers to allow Ohio Medicaid to do the following: provide a limited room and board option; share in federal Medicare savings that result from state Medicaid reforms; and establish different level of care requirements for nursing facility and home and community based services to reduce the institutional bias. ICDS will be the cornerstone of Ohio's efforts to achieve a balanced delivery system that enables seniors and persons with disabilities to live with dignity in the settings they prefer.

Promote Health Homes

The Executive Budget includes a Health Home initiative to expand on the traditional medical home model by enhancing coordination of medical and behavioral health care consistent with the needs of individuals with severe and/or multiple chronic illnesses. For Medicaid enrollees living in the community, 34 percent have at least one chronic condition and account for 70 percent of costs, totaling approximately \$7.2 billion annually. The current system of health care is uncoordinated, disjointed, and provider-centered, and provides low value to the state as a health care purchaser.

The Health Home initiative builds on medical home programs already underway throughout Ohio. It will add to these efforts by taking advantage of the federal Affordable Care Act provision that allows states to claim a 90 percent federal match for a defined set of care coordination services for individuals who are severely and chronically ill or have multiple chronic conditions for eight fiscal quarters (two years). All qualifying Medicaid patients under the care of a Health Home, including those who are dually eligible for Medicaid and Medicare, will receive these additional services. The Health Home model is independent of delivery systems and can operate within fee-for-service, managed care, or other service delivery systems.

Provide Accountable Care for Children

The Executive Budget specifically seeks to improve care coordination for disabled children and encourage the development of pediatric accountable care organizations (ACOs). Currently, 37,544 disabled children are served through Ohio's fee-for-service program at a cost of \$313 million per year. These children often have complicated and long-term medical conditions, but receive little assistance in accessing and coordinating care. Several of Ohio's children's hospitals are working to develop ACOs to provide the additional support required to meet the complex medical and behavioral health needs of disabled children.

Ongoing efforts to develop ACOs are encouraging, but many of the potential ACO sites are not ready to accept the risk and responsibilities of a free-standing ACO. As illustrated in Table 4, to begin the process, the Executive Budget enrolls disabled children who do not reside in an institution or receive home and community based waiver services in Medicaid managed care (Phase I). Managed care plans will be encouraged to form new contract relationships with developing ACOs where the ACO assumes responsibility for care coordination and a portion of the risk for enrolled children (Phase II). This allows potential ACO sites to develop and eventually decide whether or not to become a free-standing ACO (Phase III).

Table 4

Responsibility	Current	Phase I	Phase II	Phase III
Medicaid Contract	Fee-for-Service	Health Plan	Health Plan	ACO
Care Coordination	None	Health Plan	ACO	ACO
Financial Risk	Medicaid	Health Plan	Health Plan	ACO
Savings	None	Medicaid	Health Plan/ACO	ACO/Medicaid

Integrate Behavioral and Physical Health Care

In the past, Ohio has viewed the Medicaid budget and policy for individuals with severe mental illness (SMI) or alcohol and other drug addictions as separate systems: (1) physical health benefits managed by ODJFS and (2) behavioral health benefits “carved out” of ODJFS Medicaid and administered by the mental health (ODMH) and alcohol and other drug (ODADAS) systems.

These separate systems do not support coordination among providers or services at the local level. As a result, people often are served in “silos” without the benefit of shared information between providers or meaningful referrals between the physical and behavioral health systems.

The Executive Budget will integrate Medicaid behavioral health care and physical health care benefits. “Integrated care” means treating both physical health conditions and behavioral health conditions in a comprehensive, coordinated way so the patient’s physical and behavioral health practitioners work together and actively communicate about all the patient’s conditions. Integration will require changes to financing and policy. During the fiscal year 2012-2013 biennium, the Governor’s Office of Health Transformation will integrate the Medicaid alcohol and other drug treatment and mental health carve-out benefits (currently administered by ODADAS and ODMH) into the overall Medicaid program administered by ODJFS.

Elevate Behavioral Health Financing to the State

The Mental Health Act of 1988 purposefully created a funding tension within Ohio’s public behavioral health care community. State funding for state-operated psychiatric institutions was, with the closure of many of these facilities, redirected to fund community-based services. The past two decades of ODMH hospital closures, consolidations, and efficiencies have decreased hospital capacity to a minimum – one of the lowest in the nation – with those state resources being redirected to build and maintain community services. However, the tension achieved under the current funding structure is now out of balance – sufficient savings to offset the rising costs of community based services can no longer be achieved merely from hospital downsizing.

The Executive Budget “elevates” to the state the financial responsibility for community behavioral health. This will be phased in with the financial responsibility for Medicaid matching funds moving from local boards to the state in fiscal year 2012. A Medicaid-specific allocation may occur to the boards in fiscal year 2012, and boards may continue to perform administrative functions on behalf of the state as the state prepares to take over administration in fiscal year 2013. In fiscal year 2013, appropriation authority for community behavioral health Medicaid services will be included in ODJFS’ Medicaid 600525 line item.

These changes allow a better alignment of responsibility, with ODJFS administering Medicaid community behavioral health services, ODMH providing hospital level services and treatment for civil and forensic patients, and community behavioral health boards focused on developing and managing critical local community services and supports.

Manage Behavioral Health Service Utilization

The community mental health Medicaid benefit currently is operated in a different manner than the rest of Ohio Medicaid. Unlike community-based services such as dental or physician care, the community mental health benefit contains few limits on the amount, frequency, and duration of services. Without utilization management controls and cost containment measures, funding for community mental health services will not be sustainable and increased pressure will be placed on state and local financing structures. The Executive Budget proposes the following policy changes to support individuals’ recovery and at the same time manage service costs:

- Tiered rates for community psychiatric supportive treatment (CPST),
- Limits on the use of certain V-codes to crisis intervention and diagnostic assessment services,
- Establish basic benefit limits that specify the amount, frequency, and duration of services,
- Eliminate duplicate payments for mental health services provided to long-term residents of nursing facilities.

Consolidate Housing Programs

The Executive Budget consolidates administration of multiple housing programs in ODMH:

- The Residential State Supplement (RSS) Housing Program, which provides a housing subsidy for people with a variety of disabilities and needs; and,
- The Adult Care Facilities (ACF) Program, which licenses ACFs throughout the state.

Currently, RSS is managed and financed by the Ohio Department of Aging (ODA). Most subsidy recipients use their funds to stay in adult care facilities (three to five bed family homes and six to 16 bed group homes) and residential care facilities (typically 17 or more bed facilities).

Consolidating administration of these programs will result in a more streamlined and efficient administrative structure.

Rebalance Long-Term Care

The delivery system for long term services and supports in Ohio is complicated and fragmented. Individuals choose among as many as five different waivers and four Medicaid state plan delivery models found in multiple state agencies, all of which have different enrollment requirements and processes, and different service packages. Some options are available only in selected parts of Ohio. All this serves to create barriers for individuals who are eligible and want to move from one service to the other.

The Executive Budget proposes a unified long term care system so that individuals who need long-term services can easily understand their choices and how they can access services.

Acting on recent experience with programs such as Home Choice (Ohio's Money Follows the Person program), transition and diversion activities of Area Agencies on Aging, Ohio's Centers for Independent Living, and federal initiatives, the Budget will support transition and diversion activities as follows:

- Create a unified long-term care budget for people with physical disabilities and seniors and allow spending to be driven by the settings and services individuals choose rather than line item appropriations in the state budget process,
- Establish a clear "front door" into the delivery system, and,
- Replace Ohio's five HCBS waivers that serve individuals with a nursing facility level of care (PASSPORT, Ohio Home Care, Ohio Home Care/Transitions Aging Carve-out, Choices, and Assisted Living) with a single waiver program, creating a seamless delivery system for individuals needing long-term services and supports. Waivers in the Developmental Disabilities system will remain separate.

By implementing a unified delivery system for long-term services, the barriers to a balanced delivery system are removed. These policy changes are important steps toward providing consistent opportunities for choice to individuals needing long-term services and supports to live in and receive services in the settings they prefer and provide opportunities for improved care coordination. In addition, Ohio will also achieve greater transparency in price and quality by combining funds and programs for individuals needing long term services. The "Unified Long-Term Services System" also is an important element in the implementation of the Integrated Care Delivery System described above.

Evaluate PACE

The Program of All-Inclusive Care for the Elderly (PACE) serves 750 people in two sites in Cleveland and Cincinnati. PACE is the most expensive community-based option for seniors, with an average Medicaid per member per month (PMPM) cost of \$2,890. This means PACE participants are almost twice as expensive as those enrolled in PASSPORT. Despite the higher cost, individuals enrolled in PACE have a lower acuity, on average, than individuals using other long-term care models. The Executive Budget proposes to contract with Miami University's Scripps Gerontology Center to complete a comprehensive evaluation of the cost-effectiveness

of current PACE sites. This work will inform efforts to modernize the PACE program so that the rate paid for services aligns with the needs of individuals. In addition, Ohio will pursue an initiative to share savings with Medicare for dually eligible individuals enrolled in PACE. No additional PACE sites will be considered until the evaluation is complete and a shared savings program is in place.

Link Nursing Home Payments to Person-Centered Outcomes

The Medicaid rate for nursing facilities currently includes a small quality incentive payment that averages \$3.03 per day (approximately 1.7 percent of the rate). Measures used to drive the current quality incentive payment focus on business performance rather than quality of care and quality of life for people receiving services in nursing facilities. While occupancy levels and Medicaid utilization may indicate strong business performance, they do not focus on the way care is provided in a facility or on the outcomes the facility produces.

The Executive Budget proposes to modify the quality incentive payment included in the Medicaid rate for nursing facility services by replacing current quality measures with measures focused on person centered care and individualized outcomes. The new measures will align with federal requirements for nursing homes and focus on areas shown to improve the individual experience of people living in nursing homes. Examples of possible measures include a dining program where individuals can choose the foods they eat and the times they eat, rooms that are personalized to respond to individual needs, practices that allow individuals to wake up and go to bed when they please, and active support and assistance for individuals who want to transition to a community setting.

In addition to changing the quality measures, funding for nursing facility services will be repurposed so that instead of the 1.7 percent quality component in effect today, approximately 8.75 percent of the total nursing facility rate will be directly connected to the quality of care and quality of life for residents. Unlike the current model, which results in winners and losers, the new quality measures will be designed so that every nursing home in the state will have the opportunity to earn the related reimbursement and achieve the maximum rate established by Medicaid for nursing home care.

Align Programs for People with Developmental Disabilities

In 2001, Ohio took historic steps that dramatically improved the availability and quality of home and community-based services as an alternative to institutions for people with developmental disabilities. Today, nearly 30,000 individuals with developmental disabilities receive home and community based services, with federal funds supporting two-thirds of the costs. Soon, *fewer than one thousand people* will reside in Ohio's state-operated institutions (compared to 10,000 residents in 1963). Despite significant progress, inefficiencies remain in the system. Too many people wait for services, while individuals with developmental disabilities, their families, and caregivers must navigate a system of services that includes some programs administered by DODD and others by ODJFS.

The Executive Budget consolidates Medicaid programs for people with disabilities in the Department of Developmental Disabilities (DODD). It completes the system transformation that began in 2001 and creates new authority for DODD to set priorities across programs. The Budget will:

- Move the administration of the intermediate care facility for people with mental retardation (ICF/MR) program from ODJFS to DODD,
- Move the Transitions/DD waiver program from ODJFS to DODD,
- Modernize the Individual Options benefit package to include adult family care, adult foster living, respite, and remote monitoring, and,
- Consolidate funding for all DODD Medicaid programs into one line item to facilitate the movement of residents of state-operated institutions to HCBS waiver programs, and to better absorb fluctuations in individual waiver programs.

The combined impact of these initiatives gives DODD more authority and control to design programs that allow people with disabilities to move seamlessly from one setting of care to another. This is important as DODD continues to downsize state-operated institutions. The DODD's goal is reducing the average daily census from 1,258 residents to 1,078 residents by the end of fiscal year 2013. DODD will also support downsizing in the ICF/MR program by transitioning 200 individuals from ICF/MRs to waivers over the fiscal year 2012-2013 biennium.

Modernize Reimbursement

The Executive Budget includes several initiatives that move Medicaid reimbursement toward a system that pays for value instead of volume. The idea is to reset the basic rules of health care competition and payment rules so the incentive is to keep people as healthy as possible.

Modernize Hospital Payments

Ohio Medicaid uses prospective payment methods developed in the late 1980s to pay for inpatient and outpatient hospital services provided to consumers. These types of payment methodologies are volume-driven and do not reward providers for improved outcomes. The Executive Budget updates Medicaid hospital payment policies in the following areas:

- The diagnosis-related group (DRG) system,
- Outpatient services pricing,
- Outlier payments,
- Medicare crossover payments,
- Hospital acquired conditions,
- Children's hospital supplemental payments, and,
- Inpatient capital rates.

In addition, the current budget is supported by health care-related provider fees that generate matching funds to be used for Medicaid program spending. Related to these programs, the Executive Budget will:

- Extend the franchise fee in concert with a proposal by the Ohio Hospital Association,

- Extend the five percent rate increase related to the franchise fee, and
- Reauthorize the Hospital Care Assurance Program.

Reform Nursing Facility Payments

Nursing facilities are a critically important service in the continuum of long-term services and supports reimbursed by Medicaid. However, Ohioans spend more per capita on nursing homes than citizens in all but five states. Nursing facility rates are approximately \$4.75 higher than the national average, and the current reimbursement methodology does not reflect individual preferences for personalized care. The Executive Budget updates Medicaid nursing facility payment policies in the following areas:

- Establish a price for most services at the 25th percentile of historical peer group cost experience, including rates for direct care, ancillary and support services, and capital;
- Replace the existing process-oriented quality incentive payment program with a patient-oriented quality program;
- Limit Medicare crossover claims,
- Reduce the number of covered leave days, and
- Decrease the nursing facility franchise fee per bed per day assessment rate.

Reform Managed Care Plan Payments

The Executive Budget proposes the following changes to improve care coordination for Medicaid beneficiaries enrolled in managed care and to achieve cost savings through greater efficiency in managed care plan administration:

- Reduce the medical cost inflation trend and administrative components of the capitation rate,
- Include pharmacy in the Medicaid managed care benefit and develop a more standardized set of prior authorization criteria,
- Require Medicaid reimbursement to default to fee-for-service rates for hospitals that will not contract with a Medicaid managed care plan, and
- Eliminate the Children's Buy-In Program.

Reform Other Benefits and Payments

In addition to the payment reforms described above, the Executive Budget also makes reimbursement changes in the following programs:

- Nursing and Home Health Services,
- PASSPORT/Choices Waiver Services,
- Physician Payment Codes,
- Non-Emergency Transportation,
- Nutrition Products, and
- DME and Diabetic Supplies.

The Executive budget also includes authorization and funding to implement program requirements and benefit expansions mandated by the federal Affordable Care Act (ACA):

- National Correct Coding Initiative (ACA Section 6507),
- Face-to-Face DME (ACA Section 6407(d)),
- Freestanding Birthing Centers (ACA Section 2301),
- Preventive Services (ACA Section 4106),
- Smoking Cessation for Pregnant Women (ACA Section 4107), and
- Family Planning 90 percent federal match rate option.

Conclusion

This Medicaid budget is challenging but fair. It establishes a vision for overall health system performance that is based on better health, better care, and cost savings through improvement. It includes new strategies and tools in Medicaid to move in that direction. And most important, it fulfills the state's responsibility to provide health coverage for vulnerable citizens while also working to ensure taxpayers get the best possible value for their money.

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Reforming and Transforming State and Local Government

The Executive Budget utilizes four main strategies for reforming and transforming state and local government services. When combined, these strategies prepare the way for delivering high quality services to Ohio's citizens at the lowest possible cost. The Executive Budget has identified more than a dozen mandates required in statute or administrative rule that duplicate services or provide little or no benefit to taxpayers, but increase the costs for government service delivery. Increased flexibility allows elected and appointed officials to adjust and adapt to changing budgetary conditions and utilize new processes and technologies to deliver services.

Clarifying authority for and extending the opportunity to partner for shared services and collaboration across political subdivisions and within layers of government will lay the foundation for creative solutions for administrative functions. Best practices, peer comparisons, and benchmarking will aid in decision making and public awareness of the cost of government and savings opportunities. The application of 21st Century approaches and new technology provide immediate opportunities for savings and benefits to businesses and the public.

Mandate Relief

The Executive Budget reduces or eliminates state-imposed mandates, rules and regulations many of them obsolete, redundant or counterproductive that drive up local government costs, often with little or no benefit to taxpayers.

Flexibility

On some building projects, Colleges and Universities, Schools and Local Government will be able to replace multiple prime contractors with a Single Prime contractor, and use the Design Build process to share risk, create new incentives on construction projects to help bring construction costs down.

Quarterly spending plans allow county commissioners and other officials with an avenue to keep spending in line and adjust to changes in local revenues. Counties and other local governments will also be able to utilize furlough days and modified work weeks during times of fiscal distress. These changes will ensure delivery of services while maintaining fairness for employees.

Shared Services and Collaboration

The existence of more than 3,000 local government units in Ohio has produced an expensive and unwieldy field of fragmented service delivery. Governor Kasich's Executive Budget

empowers and assists local governments to collaborate through shared services arrangements as a strategy to reduce the cost of local government and increase the public value of local government services.

Four different sections of the Ohio Revised Code permit townships to collaborate with other governments for the provision of services. Cities, villages, counties, schools and many other government entities have specific statutes that require or allow for collaboration to create economies of scale or pooling to reduce costs. Government officials across the state have requested clarification of their authority to develop shared service programs and collaborate with one another. This budget creates a general provision statute that clarifies the manner in which local government and schools can partner to expand services, share resources and drive down the cost of government.

County commissions will be able to require other county offices to use centralized services for purchasing, transportation, vehicle maintenance, information technology, human resources, revenue collection, printing and mail operations. Independently-elected officials will maintain the authority to carry out their core functions, while creating economies of scale for back-office administrative functions.

There are currently multiple regional organizations in place to provide services to Ohio's schools. The maps of their overlapping service boundaries and undefined service offerings overlay the state without coordination or quantified benefit. The Jobs Budget calls for integrating these entities by July 1, 2012 with a single collection of Regional Shared Service Centers that could provide administrative support services to both school districts and local governments. Health care benefit costs have been rising annually and create an added burden to local budgets during these difficult financial times. The state has pooled its employees together to negotiate rates and create efficient health plans. Since 2006 the School Employees Health Care Board has studied the opportunities for savings and increased benefits coordination across Ohio's primary and secondary schools and institutions of higher learning. If the identified recommendations and approaches were implemented, a recent analysis has quantified more than \$300 million in potential savings. Local government officials across the state have requested the same opportunity. It's time to stop studying the problem and start working on the solution. The creation of the "Public Employees Healthcare Program" will allow local governments and schools to develop regional or statewide pools of their employees for a more efficient delivery of quality health benefits for government employees.

Introducing 21st Century Approaches

While E-Commerce and new methods of purchasing have transformed business, local governments are still required to follow processes developed in the 19th Century to communicate with citizens. We are creating a statewide public notice website available for use by all public entities. This permissive program will apply to all public notices, and bid notices.

There will be no charge to users and there is still an important role for newspapers because participants will still be required to run a smaller ad in the newspaper. This budget allows local governments to explore E-commerce opportunities and use internet tools and websites for advertising.

Foster New Approaches to Governing

The structure of local governance in Ohio and the ways in which local governments are funded have remained basically unchanged since the 19th Century, while demands placed on those governments have continually grown more complex and expensive. By reforming the ways local governments are structured and funded in Ohio, the Executive Budget helps build a new approach to governing for the 21st Century, giving communities the tools they need to strengthen the fiscal stability and quality of services provided by local governments.

###

Sustainable Funding for JobsOhio

The Creation of JobsOhio under House Bill 1

Though once considered an innovative model for the nation, over time, the core economic development mission of the Ohio Department of Development (DOD) has been diluted by the addition of auxiliary responsibilities and impeded by a growing bureaucracy. Its current structure often moves slowly while the world of business moves faster and faster.

With the loss of more than 400,000 jobs since 2006, Ohio must improve the way it approaches economic development if it is to timely and effectively respond to the challenges of the marketplace. Replacing Ohio's government-based economic development efforts with a pioneering approach, modeled after private business, will enable Ohio to become more proactive, competitive, and responsive to emerging and promising opportunities. House Bill 1 took the first key steps in this reform effort by: 1) authorizing the creation of a private nonprofit entity called JobsOhio, chaired by the governor; 2) requiring the director of the DOD to review the department and within six months make recommendations on what should be moved from DOD to JobsOhio, what should be eliminated, and what should remain within the state; and 3) authorizing the department to contract with JobsOhio to assist in performing specific duties.

Sustainable Funding for JobsOhio

The Executive Budget authorizes the transfer of Ohio's liquor enterprise to JobsOhio for an extended term. In doing so, the state will dedicate Ohio's liquor enterprise profits as an independent and sustainable source of revenue to fund Ohio's economic development efforts.

There is currently no single, dedicated, long-term source of revenue to support economic development activities in Ohio. At this time, some of the most effective job creation and retention tools available rely upon state general revenue funding. This puts funding for economic development and job creation most at risk during exactly those periods of economic downturn when this investment is most needed.

The transfer of the liquor enterprise to JobsOhio will provide a dedicated, ongoing revenue stream and free the state's economic development efforts from unpredictable state funding patterns. This ensures a steady investment in programs and services designed to create and retain jobs for Ohioans. Historically, liquor revenue has grown in a relatively stable manner and has not radically fluctuated in changing economic conditions. Dedicating this revenue stream will assure JobsOhio the resources needed to respond to difficult economic conditions quickly, flexibly, and effectively.

Description of the Transaction

The State of Ohio will transfer Ohio's liquor enterprise to JobsOhio for a period of 20 to 25 years. The final price – yet to be determined – will take into consideration JobsOhio's public purpose and accountability to public sector controls. The Executive Budget assumes that JobsOhio will provide an upfront payment of \$500 million to the General Revenue Fund to compensate the state for the foregone liquor profits. In addition, approximately \$700 million will be necessary to legally discharge the state's outstanding bonds that are secured by liquor profits. The transfer agreement, which is currently targeted for execution in January 2012, may also provide for annuity payments to the state in fiscal years 2014 and thereafter.

The specific terms of the transfer will be negotiated with JobsOhio by the director of the Office of Budget and Management, in conjunction with the directors of the Departments of Development and Commerce. The transfer and its terms will assume the existing regulatory environment, which includes a single wholesale system, limited sales, a proscribed profit margin, and restrictions on availability. Should the state materially change that regulatory environment in such a way that impacts the value of the enterprise, either positively or negatively, the terms of the agreement can be renegotiated.

JobsOhio's Leveraging of the Wholesale Liquor Profits

Simultaneous with the transfer of the state liquor enterprise to JobsOhio, the organization anticipates issuing bonds backed by the liquor profit revenue stream to fund the upfront payment to the state and provide the amount needed to discharge the state's outstanding bonds that are payable from liquor profits.

On an ongoing annual basis through the term of the agreement, JobsOhio will use the liquor profits to: 1) pay debt service on its bonds; 2) fund ongoing economic development activities and operating costs; and 3) make any annuity payments to the State of Ohio.

Operation of the Liquor System

The profits from the state's liquor enterprise are currently used to pay for both the regulatory and merchandising activities related to that liquor enterprise. These activities are housed within the Ohio Department of Commerce and in the Ohio Liquor Control Commission. While the merchandising portions of the liquor enterprise will be transferred to JobsOhio, the state will retain all regulatory control, including licensing issuance, enforcement, prosecution, and suspension. After the execution of the agreement, the Executive Budget funds these regulatory activities from the General Revenue Fund. This totals approximately \$11 million per fiscal year.

The Executive Budget anticipates that JobsOhio will contract with the Ohio Department of Commerce for the continuing performance of the liquor enterprise merchandising functions.

The initial contract will be for a term ending June 30, 2013, with options for renewal. These merchandising functions include inventory management and a distribution system that includes and contracts for warehousing, shipping, and a fleet of vehicles. The original contract and any subsequent contract renewals between JobsOhio and the Department of Commerce will be negotiated between those two entities.

Impact on Other State Agencies

Revenue generated by liquor licensing activities -- approximately \$36 million annually -- will continue to be divided among the General Revenue Fund, local governments, and the Ohio Department of Alcohol and Drug Addiction Services. The Executive Budget does not change the method of this distribution.

Profits from the liquor enterprise currently fund several other state activities outside of the Department of Commerce. The Executive Budget provides funding for these activities, after the execution of the transfer, primarily by shifting them to general revenue funding. These include:

- Ohio Department of Alcohol and Drug Addiction Services, which currently uses approximately \$4 million annually for its treatment and prevention fund.
- Ohio Department of Public Safety, which currently uses approximately \$11 million annually for enforcement of the state's liquor control laws, including issuance of citations and arrests.
- The Ohio Department of Health, which currently uses approximately \$1 million annually for formulation and enforcement of alcohol testing protocols and equipment.
- The Liquor Control Commission, which currently uses approximately \$750 thousand annually to fund activities, staff, and hearings expenses.

Facilities Establishment Fund

The Executive Budget also authorizes the State of Ohio to transfer the Facilities Establishment Fund to JobsOhio. JobsOhio anticipates a contract with the state to maintain and service the loan portfolios which exist within the Facilities Establishment Fund today.

The Facilities Establishment Fund, held by the Treasurer of State on behalf of DOD, was originally seeded by liquor profit bonds beginning in 1982. It is intended to be a self-sustaining revolving loan fund from which the state originates economic development incentive loan programs. The loans made from this fund serve as an essential economic development tool for creating new jobs and expanding investment in Ohio.

JobsOhio will continue to collect loan repayments and will recycle this cash into second generation loans, thus creating a more dynamic, revolving loan program. JobsOhio will continue to manage the fund and its assets for long-term viability and leverage it to maximize job creation in the State of Ohio.

###

Redirection of State Revenue Streams

Redirection of State Revenue Streams

**Changing the Schedule for Reimbursement of Lost Property Taxes
and Moving Dedicated Taxes from Special Funds to the State GRF**

The estimates contained in this paper of the current-law phase out of property tax replacement payments and the administration's proposal are based on the best information available to the administration at this time. Some of the underlying data are still being revised or updated, and so the amounts shown in the summary tables in this document may differ from detailed tables that are eventually released. The administration believes that the revisions will not be large and will not change the conclusions reached herein.

Introduction

The administration inherits two very costly legacy programs to reimburse schools and local governments for local property taxes that were eliminated due to state law changes. These law changes were made years ago. To be specific, the law changes that reduced public utility tangible property (PUTP) taxes as part of electric power generation deregulation and natural gas deregulation were made in 1999 and 2000, respectively. The law change that reduced tangible personal property (TPP) taxes as part of a tax reform package meant to stimulate economic growth, particularly in manufacturing, was made in 2005.

Under current law, there are state taxes dedicated to generating revenue for the property tax replacement payments. The kilowatt-hour (KWH) tax and natural gas distribution (MCF) tax are earmarked in part (KWH) or whole (MCF) for the reimbursement of schools and local governments for property taxes lost due to electricity and gas deregulation. The Commercial Activity Tax (CAT) is earmarked in whole (through fiscal year 2011) and then in part (fiscal year 2012 and subsequent years) for replacing the TPP taxes lost due to tax reform.

The costlier of the two replacement programs, by far, is the TPP tax reimbursement program. The repeal of the TPP tax resulted in \$1.65 billion in lost property tax revenue to school districts and local governments (plus an additional loss of almost \$200 million in repealed property taxes on telecommunications providers, which had before tax reform been classified as public utility property taxes). The law which repealed the TPP tax, HB 66, originally established a five-year "hold harmless" period (2006-2010), during which school districts and local governments would be fully reimbursed for lost property taxes. At the same time, the new CAT was being phased in, with CAT revenues earmarked to pay for the reimbursements. The budgetary problem that has evolved, however, is that in recent years the CAT has actually not generated sufficient revenue to pay for those replacement payments.

As one can see from Table 1, below, while the CAT in its early years generated enough revenue to pay for the TPP tax replacement payments, for FY 2009-2010 there were large shortfalls that had to be paid for by transfers from the state GRF to the replacement funds, and even after

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FY 2011 estimates for CAT revenue have been revised upward, another large shortfall is expected in FY 2011 (the current year).

Table 1 -Commercial Activity Tax Revenues vs. Required TPP Tax Replacement Payments					
(\$ in millions)					
	FY 2007 Actual	FY 2008 Actual	FY 2009 Actual	FY 2010 Actual	FY 2011 Estimate
Total CAT Revenues (1)	\$594.9	\$963.7	\$1,179.2	\$1,341.6	\$1,436.9
GRF Revenues (2)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Required Tangible Property Tax Replacement Payments	\$571.3	\$931.6	\$1,275.0	\$1,624.0	\$1,649.3
Surplus to GRF / (Shortfall paid from GRF)	\$23.6	\$32.1	(\$95.8)	(\$282.4)	(\$212.4)
<p>1 The state GRF does not directly receive CAT revenues in FY 2007-2011. Any excess revenues over the required TPP replacements may be transferred by the OBM director to the GRF. On the other side, any shortfall in CAT revenues to make the replacement payments must be made up from the GRF. Beginning in FY 2012, the GRF begins to receive a statutory percentage of revenues that had previously been allocated to the school and local government replacement payments.</p>					

The second program, to replace PUTP taxes lost due to electricity and natural gas deregulation, does not suffer from revenues being insufficient to make the required reimbursement payments. In fact, the revenues from the KWH tax and the MCF tax generate somewhat more revenue than needed to make the required replacement payments. So, in FY 2010, about \$32 million in combined KWH tax and MCF tax revenue was transferred from the school district replacement fund back to the GRF.

However, as later sections of this document will show, much of the utility tax reimbursement is going to school districts and local governments where it represents a rather small portion of the district's budget, while there are relatively few districts (mostly those that contain electric generating plants) where the utility reimbursement is a significant source of local resources. The administration has concluded that the replacement payment allocation should be changed to focus on those districts with replacement payments that are a significant share of their budget.

The Mechanics of the Reimbursement Programs

Current Law

Under current law, TPP tax replacement payments to schools and local governments run through 2018, before being eliminated in 2019 (although 70% of the CAT is earmarked to

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generate money for school districts in perpetuity, through an as-yet unidentified allocation formula). Deregulation PUTP replacement payments for school districts and joint vocational school (JVS) districts may run 15 years, from 2002 through 2016, before being essentially eliminated in 2017. Direct payments for school districts may be eliminated earlier if state aid to the districts increases by a large enough amount. Deregulation PUTP replacement payments to local governments also continue for 15 years, through 2016. However, after payments to local governments are “phased-out,” in fact current law continues distributing PUTP replacement payments to local governments in perpetuity through an allocation formula adopted when the deregulation bills passed.

When the tax reform package was adopted in 2005, TPP tax replacement payments to school districts were broken into two pieces, those for “fixed-rate” levies, where revenues from the levy change with valuation changes, and “fixed-sum” levies (debt and emergency levies), where revenues from the levies are constant and it is the tax rates that change to bring in constant annual revenue amounts.¹ School district replacement payments were further differentiated from local government replacement payments by the fact that some school reimbursement comes to the school district through the state school aid formula. Because the school aid formula provides more aid to districts with lower taxable values per pupil (lower tax capacity), the reduction in TPP values as the TPP tax was eliminated acted to increase state aid to school districts proportionally. The increased aid to school districts through the state aid formula is permanent. However, under current law, any fixed-rate TPP tax replacement payments to school districts above what is provided through the state aid formula (“direct payments”) eventually are phased out. Originally, that phasing-out was to begin in FY 2012 and to end in FY 2019. Under the last state budget bill, HB 1, 100 percent reimbursement was extended through FY 2013, with the phasing-out now beginning in FY 2014.

A simplified chart of the reimbursement of fixed-rate levies during the phase-out period is shown in Table 1a, which follows:

¹The characterization of fixed-rate levy revenue as changing with valuation is an oversimplification. Fixed-rate levy revenue does change with valuation changes, but that change is greatly restricted by what are known as the House Bill 920 tax reduction factors, which essentially work to keep revenue from voted levies constant when valuation changes due to property reappraisal or update. An important exception to this restriction on revenue changes exists for school district fixed-rate levies where the district is at what is known as the 20-mill floor.

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Table 1a - TPP Tax Replacement Schedule for "Fixed-Rate" Levies										
HB 66 is the original tax reform/budget bill from 2005; HB 1 is the FY 2101-2011 budget bill, passed in July 2009										
	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19
TPP Tax Replacement to Schools										
See ORC 5751.21 (C) (10) through (C) 19										
percentage of direct payment (non-formula reimbursement) guaranteed to district, HB 66	100%	100%	14/17	11/17	9/17	7/17	5/17	3/17	1/17	0
percentage of direct payment (non-formula reimbursement) guaranteed to district, HB 1	100%	100%	100%	100%	9/17	7/17	5/17	3/17	1/17	0
		Tax Year 2010	Tax Year 2011	Tax Year 2012	Tax Year 2013	Tax Year 2014	Tax Year 2015	Tax Year 2016	Tax Year 2017	Tax Year 2018
TPP Replacement to Local Governments										
See ORC 5751.22 (A) (1) (a) through (A) (1) (i)										
percentage of payment guaranteed to district, HB 66		100%	14/17	11/17	9/17	7/17	5/17	3/17	1/17	0
percentage of payment guaranteed to district, HB 1		100%	14/17 (a)	11/17	9/17	7/17	5/17	3/17	1/17	0
(a) The reimbursement to local governments in tax year 2011 is 14/17, except that the May-2011 payment (1/7 of the tax year 2011 total) is at 100 percent										

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Utility tax replacement payments to school districts, which actually pre-date the TPP tax replacement payments (the utility tax replacement payments started in FY 2002) share some features with the TPP tax replacement payments. Levies are divided into fixed-rate and fixed-sum levies. Direct payments are made to school districts for any required replacement payments that are not taken care of through the state aid formula. The phasing-out of school district direct payments began in FY 2007 through the application of a test that compared the school district's increase in state aid since FY 2002 with its inflation-adjusted utility property tax loss. For school districts whose state aid increase exceeds its utility property tax loss, utility property tax reimbursement direct payments have been stopped. In FY 2011, only 133 of the 614 school districts were still receiving utility tax reimbursement direct payments.

For local governments, TPP tax replacement payments and utility tax replacement payments do not have the state education aid complication. All replacement payments take the form of direct payments. Under current law, the TPP tax reimbursement payments begin phasing out in FY 2012 (the first payment subject to the phase-out is the August 2011 payment). Utility tax replacement payments began phasing out in calendar year 2007. However, local government utility tax payments never end, in a sense (see below).

When direct reimbursement payments to schools and local governments end, the dedicated taxes do not revert to the state General Revenue Fund (GRF). Instead, they continue to be deposited into the funds that reimburse the schools and local governments. However, some of the utility tax school district revenue does eventually get transferred back to the GRF. Revenues in the utility tax school reimbursement fund that exceed what is necessary to make the direct payment replacement payments to school districts go to the "Half-Mill Equalization Fund." The Half-Mill Equalization Fund is used to supplement the local contribution to a district's School Facilities Commission-assisted building project if the district has below-average per-pupil property valuation (payments to a school district are to be used for maintenance of new or renovated buildings). However, any balances in the Half-Mill Equalization Fund not needed for that purpose must be transferred to the General Revenue Fund. In FY 2010, about \$32 million in excess utility tax revenues were transferred to the GRF.

For local governments, one-half of the dedicated tax revenue is distributed to each county in proportion to each county's population. The other half is distributed to each county in the proportion that the tax losses from the utility property tax changes for all taxing units in the county is of the total utility tax losses from all local taxing units in the state.

Bond levies are an exception to the fixed-year limitations outlined above. Bond levies qualifying for reimbursement are reimbursed until the debt is retired. Qualifying emergency levies are reimbursed in full as long as the levy remains in place, through FY 2018.

Administration Proposal

The administration proposal would permanently change both the public utility tax reimbursement and TPP tax reimbursement programs. The basic concept underlying the administration

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proposal is that continued replacement payments should be based on a measure of relative need, for school districts, JVS districts, and local governments. So, the administration proposal first constructs measures of reliance on the replacement payments for school districts, JVS districts, and local governments. Reliance is measured in terms of the percentage of the total revenue resources available to the district or government for current operating expenses. The reimbursement to the unit is then phased out by a uniform rule, whereby no more than two percent of the unit's total revenue resources are removed each year. The two replacement programs are considered separately, meaning a district could lose up to four percent of its resources in a given year. So, for a school district, JVS, or local government that gets less than 2 percent of its resources from TPP reimbursement or utility deregulation reimbursement, the entire reimbursement amount is eliminated in the first year of the proposal (the second half of tax year 2011 for local governments and fiscal year 2012 for school districts and JVS districts). For a unit with greater than 2 percent reliance on either TPP reimbursement or utility deregulation reimbursement, the reduction in reimbursement in the first year is an amount equal to 2 percent of the calculated total resources for the unit. This 2 percent of resources reduction takes place in all subsequent years, as well. So, for example, a school district with 7.5% reliance on TPP reimbursement and 0.8% reliance on utility deregulation reimbursement would lose its utility deregulation reimbursement in FY 2012, but its TPP reimbursement would be reduced by an amount equal to 2 percent of calculated resources in FY 2012, FY 2013, and FY 2014, before being eliminated in FY 2015.

The changes to the replacement payments are accompanied by law changes that redirect CAT and KWH and MCF tax revenues from the dedicated reimbursement funds to the state GRF.

Under current law, all CAT revenues go to the school district reimbursement fund (70%) and local government reimbursement fund (30%) through FY 2011. Beginning in FY 2012, as the phase-down of the local government replacement payments begins, some of the CAT is deposited in the state GRF, and the share of the CAT deposited into the local government reimbursement fund declines annually until it reaches zero in FY 2019, at which point the GRF share of CAT revenue becomes 30 percent. The shares of the CAT deposited into the GRF in FY 2012 and FY 2013 are 5.3% and 10.6%, respectively.

The administration proposal would instead deposit 25% of the CAT into the state GRF in FY 2012 and 50% of the CAT into the state GRF in FY 2013. These revenues will still not quite be enough to make the reimbursement payments in those years, but the estimated amount of the GRF subsidy required in FY 2012 and 2013 will be much smaller than the amounts shown for FY 2101-2011 in Table 1. The estimated GRF transfers necessary to make the replacement payments are estimated to be \$36 million in FY 2012 and \$58 million in FY 2013. In FY 2014 and subsequent years, the GRF share of the CAT steadily increases until it reaches 100% in FY 2021 (there are still some TPP tax replacement payments to be made in FY 2021 and thereafter, but the amounts are projected to be small enough that they can be dealt with by GRF appropriation rather than requiring a dedicated tax source).

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The shares of the CAT dedicated to the GRF and to the two TPP property tax replacement funds under both current law and the administration proposal are shown in Table 2, which follows:

Table 2: CAT Revenue Allocation by Fund, Current Law vs. Proposal			
Fiscal year	General Revenue Fund	School District Tangible Property Tax Replacement Fund	Local Government Tangible Property Tax Replacement Fund
Current Law			
2011	0.0%	70.0%	30.0%
2012	5.3%	70.0%	24.7%
2013	10.6%	70.0%	19.4%
2014	14.1%	70.0%	15.9%
2015	17.6%	70.0%	12.4%
2016	21.1%	70.0%	8.9%
2017	24.6%	70.0%	5.4%
2018	28.1%	70.0%	1.9%
2019 and thereafter	30.0%	70.0%	0.0%
Proposal			
2012	25.0%	57.0%	18.0%
2013	50.0%	38.0%	12.0%
2014	72.6%	20.8%	67.6%
2015	83.9%	13.4%	2.7%
2016	88.6%	9.8%	1.6%
2017	90.7%	8.0%	1.3%
2018	92.3%	6.7%	1.0%
2019	97.0%	3.0%	0.0%
2020	98.0%	2.0%	0.0%
2021 and thereafter	100%	0%	0.0%

For utility deregulation replacement payments, the situation is similar. Under current law, all of the MCF tax revenues are dedicated to the two replacement funds, with 68.7 percent of

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revenues going to the school replacement fund and the other 31.3 percent of revenues going to the local government replacement fund. KWH tax revenues, in contrast, are split between the state GRF and the two replacement funds. The state GRF gets 63 percent of KWH tax revenue, while 25.4 percent goes to the school district replacement fund and 11.6 percent goes to the local government replacement fund.

The administration proposal would change the allocation of MCF and KWH tax revenues in conjunction with the phasing out of the utility tax replacement payments. The MCF tax would be dedicated 100 percent to the state GRF. The KWH tax allocation would be changed as shown in Table 3, below.

Table 3 - KWH Tax Revenue Allocation by Fund, Current Law vs. Proposal			
Fiscal year	General Revenue Fund	School District Utility Property Tax Replacement Fund	Local Government Utility Property Tax Replacement Fund
Current Law			
2011	63.0%	25.4%	11.6%
2012 and thereafter	63.0%	25.4%	11.6%
Proposal			
2012	88.0%	9.0%	3.0%
2013	89.0%	8.0%	3.0%
2014-2020	90.0%	8.0%	2.0%
2021-2030	93.0%	6.0%	1.0%
2031 and thereafter	100%	0%	0.0%

The reason that the phase-out of dedicated revenues to reimbursement funds is so much longer for the KWH tax than for the CAT is that there are a small number of districts, those that contain or contained electric power plants, that have a very high degree of reliance on utility tax replacement payments, and so the phase-out restriction of 2% of resources per year means that replacement payments continue for a very long time.

The remaining sections of this analysis go into some detail about the calculation of the reliance measure, including the special calculations made for counties, the kinds of levies that are

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exempt from the general phase-out schedule for replacement payments, and the estimated impacts of the phase-out on school districts and on different types of local governments.

Construction of the TPP Reimbursement and Utility Deregulation Reimbursement Reliance Measures and Examples of the Phase-Out Proposal

Since the phase-out of TPP tax replacement payments and utility tax replacement payments depends on the measured reliance of each school district, JVS, and local government unit on those payments, the calculation of the reliance measure is a crucial part of the administration proposal. The administration decision was to use revenue data rather than spending data to construct the reliance measures. First, there is a theoretical argument that reliance on property tax replacement payments should be measured as a share of the total resources available to the unit. Second, as a practical matter, revenue data proved to be much easier to attain than spending data for the school districts and various types of local governments. In all cases the administration proposal uses the latest comprehensive data available in the reliance calculations. Some of the data are, by necessity, from different years.

School Districts

The calculations are somewhat different between the school districts and the local governments. For the school districts, the “total resources” variable is the sum of local property taxes, state education aid for FY 2010, school district income tax collections for FY 2010, TPP tax replacement payments for FY 2010 (for non-debt levies), and utility tax replacement payments for FY 2010 (for non-debt levies).² The TPP tax reimbursement for FY 2010 for fixed-rate current expenses (no debt or emergency levies) is then divided by the total resources variable to obtain the TPP reimbursement reliance measure for each school district. The same calculation is used for JVS districts (except that JVS districts do not have income tax revenue). Similarly, the utility tax reimbursement for FY 2010 is divided by the total resources available to obtain the utility reimbursement reliance measure for each school district and JVS district.

For school districts, the calculated total resources figure for FY 2010 is \$15.80 billion.

The numerator of the calculation is the TPP tax reimbursement or utility tax reimbursement **excluding** emergency levies, debt levies, and non-current expense fixed-rate levies. Reimbursement payments for debt levies and emergency levies are not subject to the new phase-out proposal, but are instead treated the same as under current law. As noted previously, under current law, full replacement payments for debt levies continue as long as the levy is in place, until the bonds are retired, and full replacement payments for emergency levies are made through fiscal year 2018 as long as the emergency levy remains in effect. Replacement

² Local property taxes are the sum of half the tax year 2008 and half the tax year 2009 current expense property taxes, including state payments for the 10% rollback, 2.5% rollback, and homestead exemption.

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payments for non-current expense fixed-rate levies are phased-out over four years beginning in FY 2012, with the exception of inside millage debt levies, which continue as under current law.

A sample calculation of reliance is presented for a school district in Table 4, below.

Table 4- Reliance Calculations for Indian Lake Local SD in Logan County			
[A]	[B]	[C]	[D]
FY 2010 TPP Fixed-Rate Direct Reimbursement	FY 2010 TPP Fixed-Sum Reimbursement	FY 2010 Utility Fixed-Rate Direct Reimbursement	FY 2010 Utility Fixed-Sum Direct Reimbursement
\$927,293	\$78,417	\$86,936	\$5,403
[E]	[F]	[G]	[H=sum of A To G]
FY 2010 State Aid	Property Taxes Including Rollbacks	FY 2010 School District IT	FY 2010 Total Resources
\$4,963,651	\$9,411,430	\$0	\$15,473,129
[I = A/H]	[J = B/H]	[K]	
2010 TPP Fixed-Rate Reimbursement % of Total Resources	Utility Reimbursement % of Total Resources	FY 2011 TPP-Fixed Rate Direct Reimbursement	2011 TTP Fixed-Rate Reimbursement % of Total Resources
5.99%	0.56%	\$942,429	6.09%

Indian Lake Local School District (LSD) has slightly higher reliance on TPP and Utility tax replacement payments than the statewide averages for school districts, which are 5.71% and 0.43% respectively.

Indian Lake LSD would lose its \$86,936 utility tax reimbursement for fixed-rate current expense levies (but not for debt and emergency levies) in fiscal year 2012. Its TPP tax replacement payments for fixed-rate current expense levies would be phased out in the following way: 2% of total resources in fiscal year 2012 (\$309,463), 2% of total resources in fiscal year 2013 (another \$309,463), 2% of total resources in fiscal year 2014 (another \$309,463) and the remaining .09% of resources in fiscal year 2015 (the remaining \$14,040). Even though the percentage of resources in the base FY 2010 calculation shows a reliance of just under six percent, the reduction based on FY 2011 direct replacement payments are still limited to two percent of total

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resources, essentially extending some reimbursement an additional year. Indian Lake LSD's TPP tax and utility tax replacement payments would thus be as shown in Table 5, below:

Table 5 - Proposed TPP and Utility Fixed-Rate Levy Reimbursement Example for Indian Local SD						
	FY 2010 Actual	FY 2011 Actual	FY 2012 Proposed	FY 2013 Proposed	FY 2014 Proposed	FY 2015 Proposed
TPP Reimbursements	\$927,293	\$942,429	\$632,966	\$323,503	\$14,040	0
Reduction			\$309,463	\$309,463	\$309,463	\$14,040
Utility Reimbursements	\$86,936	\$86,936	\$0			
Reduction			\$86,936			

Local Governments

The reliance calculations for the local governments follow the same general concept as those for the school districts and JVS districts. The denominator of the measure is a calculated amount of total resources for current expenses. The variables that enter into the denominator of the reliance calculations differ depending on the type of local government.

The numerators of the reliance calculations are essentially the same as those for school districts. For the TPP reimbursement reliance measure, it is the TPP tax reimbursement for calendar year 2010 for fixed-rate current expenses. TPP reimbursements for debt, capital projects, and pensions have been excluded from the calculation. The utility tax numerators also have only the current expense levy reimbursements included.

Municipalities, townships, and special districts have very similar reliance calculations and phase-out formulae. The treatment of the counties is somewhat different. For the counties, there are four different types of levies that are all treated separately, almost as if the service provided by the levy was provided by its own unit of government. The four types of levies, corresponding to four categories of service provision, are:

- (1) Mental health and developmental disabilities
- (2) Senior services
- (3) Children's services
- (4) Public health

County general fund levies are combined with all other types of county levies into a fifth category, which has its own reliance measures and phase-out formula.

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The variables included in the total resource calculation, as well as the estimated amount of total resources for 2010, for each type of local government, are shown in Table 6, below.

Clearly, municipalities have the largest total resources for current expenses to draw from (\$5.49 billion) due mostly to their municipal income tax collections, which reached \$4.15 billion in 2008 (slightly more than three quarters of the computed total). Counties are second in total resources for current expenses at their disposal, with \$4.34 billion. For counties, local property taxes are by far the biggest source of current expense revenue, at \$2.76 billion. County permissive sales taxes contribute another \$1.10 billion.

Table 6 - TPP Tax and Utility Tax Reimbursement Reliance Measures for Local Governments		
dollar amounts in millions		
Government Type	Variables Included in "Total Resource" Calculation	Total Resources
Municipality	local property taxes, median annual estate taxes, local admissions taxes, municipal income taxes, local government fund (LGF) distributions, TPP tax reimbursements, Utility tax reimbursements	\$5,494.8
Township	local property taxes, LGF distributions, TPP tax reimbursements, Utility tax reimbursements	\$1,006.9
Special District	local property taxes, LGF distributions, TPP tax reimbursements, Utility tax reimbursements	\$741.6
County General	local property taxes, LGF distributions, county sales taxes, TPP tax reimbursements, Utility tax reimbursements	\$2,376.6
County MH/DD	local property taxes, TPP tax reimbursements, Utility tax reimbursements	\$1,244.1
County Children's Services	local property taxes, TPP tax reimbursements, Utility tax reimbursements	\$350.5
County Public Health	local property taxes, TPP tax reimbursements, Utility tax reimbursements	\$264.2
County Senior Services	local property taxes, TPP tax reimbursements, Utility tax reimbursements	\$102.6

As mentioned above, for purposes of computing reliance measures, and calculating the phase-out of reimbursements, counties are not regarded as a whole, but instead the reimbursements

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are segregated by levy type (expense category). County mental health and disability resources alone are greater than township resources.

Once resources are calculated, reliance measures can be computed. The TPP tax and utility tax reimbursements that are included in the numerator are only those reimbursements for fixed-rate levies for current expenses. The TPP Tax and utility tax reimbursements are for fixed-rate, current expense levies. They are only for "direct payments" i.e. additional school district formula aid is not counted.³ Reliance on TPP tax and utility tax reimbursements differs markedly by type of government. As Table 7, below, shows, school districts have the largest reimbursements in dollars, but they do not have the highest degree of dependency. The townships have the greatest average reliance on utility tax reimbursements, while county mental health and developmental disability services have the greatest dependency on TPP tax reimbursements.

Of course, the averages by type of government conceal wide variation within the category. Cuyahoga Heights Local SD has a computed 30.7% reliance on TPP tax reimbursements. Under the administration proposal, Cuyahoga Heights will not see its TPP tax reimbursements fall to zero until FY 2027 (although in Table 1, the share of the CAT that goes to the reimbursement fund falls to zero in FY 2021, that does not mean that reimbursements stop – rather, by FY 2021 the aggregate reimbursements are small enough that they will be satisfied by GRF appropriation rather than by dedicated taxes).

[Table 7 follows]

³ For this reason, the reimbursement totals by type of government will differ from (specifically, be less than) the totals shown on the Department of Taxation's Website.

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Table 7 - TPP Tax and Utility Tax Reimbursement Reliance Measures for School Districts, JVS Districts, and Local Governments					
dollar amounts in millions					
amounts shown are for FY 2010 (schools) or calendar year 2010 (non-schools)					
Government Type	Total Resources	Total TPP Tax Reimbursement	Total Utility Tax Reimbursement	TPP Reimbursement Reliance	Utility Reimbursement Reliance
School Districts	\$15,804.3	\$903.00	\$68.70	5.7%	0.4%
JVS Districts	\$619.3	\$32.79	\$6.34	5.3%	1.0%
Municipality	\$5,494.8	\$69.86	\$8.59	1.3%	0.2%
Township	\$1,006.9	\$58.81	\$12.09	5.8%	1.2%
Special District	\$741.6	\$54.78	\$7.61	7.4%	1.0%
County General	\$2,376.6	\$88.85	\$13.71	3.7%	0.6%
County MH/DD	\$1,244.1	\$115.65	\$13.02	9.3%	1.0%
County Children's Services	\$350.5	\$31.00	\$3.71	8.8%	1.1%
County Public Health	\$264.2	\$20.39	\$1.94	7.7%	0.7%
County Senior Services	\$102.6	\$7.56	\$1.10	7.4%	1.1%

With respect to utility tax reimbursements, there are four (4) school districts with reliance measures from 28.7% to 39.6% (after those four, the next highest utility tax reimbursement reliance for a school district is 5.0%). Under the administration proposal, those districts will not see their utility tax reimbursements go to zero until calendar years 2025-2030. On the other hand, many school districts and JVS districts have less than 2% reliance on utility tax reimbursements and so will see their reimbursement go to zero in tax year 2011 (state fiscal year 2012).

Among the local governments, there are somewhat more extreme divergences in reliance within and among types of government. For example, there are six townships whose TPP tax reimbursement reliance exceeds 50 percent of total resources (although the total TPP reimbursement for these townships in 2010 was slightly less than \$2 million). There are also two municipalities and six special districts with TPP tax reliance of 50 percent or more. The administration proposal sets the last year for TPP reimbursement payments for any type of government to be calendar year 2030 – payments are not allowed to continue until calendar year 2042 (the maximum reliance measure is 63.4% for Scioto Township in Pike County).

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For the utility tax reimbursements, the reliance figures, although skewed toward those governments with electric generating plants, are not quite so extreme. Only one government, the village of Moscow in Clermont County, has a reliance on utility tax reimbursement of greater than 50%, at 50.5% (in fact, there are only three (3) municipalities over 15% reliance). The township with the greatest reliance on utility tax reimbursement is also in Clermont County – Washington Township, at 44.2%. There are a dozen townships with reliance of 20 percent or more.

An appendix to this document, contains groupings of governments by reliance percentages, by type, along with current updates, will be available on the Ohio Department of Taxation website (www.tax.ohio.gov), under the “Government” tab.

Budgetary Savings from the Administration Phase-Out Proposal

As one might expect, given that the reimbursement amounts for school districts and JVS districts are much larger than for local governments, the budgetary savings from the administration's proposed phase-out of the school and JVS reimbursements is also much larger than the local government savings.

For school districts alone, the TPP tax current expense fixed-rate reimbursements eliminated in the FY 20102-2013 biennium are approximately \$295 million and \$525 million, respectively. These savings are 32% and 57%, respectively, of the FY 2011 amount of \$927 million. Because school districts with relatively low reliance on TPP tax reimbursements have their reimbursement eliminated in the first two years (FY 2012-2013) leaving a group of school districts with much higher reliance to have their reimbursements eliminated more slowly, the phase-out rate slows markedly after FY 2013. Estimated phase-out rates for FY 2014-2016 are approximately 73%, 84%, and 89% of the FY 2011 base amount, respectively.⁴

School districts also are receiving TPP tax reimbursements for levies which are fixed-rate levies but are not for current operating expenses. These reimbursements amounted to \$26.5 million in FY 2011 (less than 3% of the current expense TPP tax school district reimbursements). These reimbursements are also phased out under the administration proposal, but under a much simpler method that does not involve the computation of reliance percentages. One quarter of the reimbursements are eliminated each year over the four year period from FY 2012 – 2015, so that these reimbursements fall to zero in FY 2015.

⁴ Since under current law, based on the amendment to HB 66 passed in HB1, there is no phase-down at all of school replacement payments in FY 2012 or FY 2013, all reductions from the FY 2011 base amount in those years are also a reduction relative to current law. As Table 1 illustrates, in FY 2014 and later years the situation becomes more complicated, because even under current law fixed-rate reimbursement is only 9/17 of the FY 2011 base amount in FY 2014, 7/17 in FY 2015, and so on.

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For JVS districts the same principle applies as for school districts. The current expense levy replacement payments are phased out based on reliance, but the small amount of non-current expense levy replacement payments are phased out on a straight-line four year schedule.

Table 8 School and JVS TPP Fixed-Rate TPP Tax Replacement Payments for FY 2011-2013, Administration Proposal (millions of dollars)					
Entity Type	Fixed-Rate Levy Type	FY 11 TPP Tax Reimbursement	FY 12 Reimbursement Reduction	FY 13 Reimbursement Reduction	
School District	Current Expense	\$926.9	\$295.5	\$524.9	
	pct reduction		31.9%	56.6%	
	Non- Current Expense	\$26.5	\$6.6	\$13.3	
	pct reduction		25.0%	50.0%	
	JVS District	Current Expense	\$33.4	\$12.3	\$22.5
	pct reduction			36.6%	67.4%
	Non- Current Expense	\$1.4	\$0.35	\$0.7	
	pct reduction		25.0%	50.0%	
Total School District and JVS District		\$988.3	\$314.7	\$561.4	
			31.9%	57.0%	

For the local governments, the administration does not yet have final data on FY 2011 TPP tax reimbursements, so the calculations in Table 9 are shown relative to tax year 2010 reimbursements. As with the school districts, the use of the reliance measures is used to phase-out current expense fixed-rate levy replacement payments, while non-current expense replacement payments are phased out 25% percent per year starting in tax year 2011, dropping to zero in tax year 2014.

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Table 9 - Proposed Phase-Out of Local Government TPP Payments			
Includes Current Expense Levies and Others			
in millions of dollars			
	TY 2010	FY 2012	FY 2013
County TPP Reimbursements	\$267.6	\$160.8	\$107.1
Municipality TPP Reimbursements	\$90.4	\$22.2	\$12.4
Township TPP Reimbursements	\$69.4	\$43.8	\$30.9
Special District TPP Reimbursements	\$54.9	\$36.0	\$25.4
Total Local Government TPP Reimbursements	\$482.3	\$262.8	\$175.7
Reimbursement Eliminated Relative to Tax Year 2010 - Proposed		\$219.5	\$306.6
Percentage of Reimbursement Eliminated		45.5%	63.6%
Reimbursement Eliminated Relative to Tax Year 2010 - Current Law		\$66.3	\$151.3
Savings Relative to Current Law		\$153.2	\$155.3

Thus, the combined budgetary savings from the change to the TPP tax reimbursements under the administration proposal is \$468 million in FY 2012 and \$717 million in FY 2013.

In the interest of simplifying the presentation and saving space, the budgetary savings for the administration proposal for the utility deregulation tax replacement payments for schools and local governments are combined in Table 10, below. \

The total budgetary savings from the administration's proposed utility tax reimbursement phase-out is \$104 million in FY 2012 and \$110 million in FY 2013.

Comparing Table 10 with Tables 8 and 9, one can see that the proposed phase-out of utility tax reimbursements works much faster than the proposed TPP tax reimbursement phase-out, with almost three quarters of the replacement payments being removed in FY 2012. This is because, as shown in Table 7, the reliance measures for utility tax replacement payments are so much lower on average than for TPP tax replacement payments. This rapid phase-out allows the

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reallocation of the entire MCF tax (forecast at \$66 million per year) to the GRF, and a significant reallocation of the KWH tax from the replacement funds to the GRF, as shown in Table 3.⁵

Table 10 - Proposed Phase-Out of Local Gov't. Utility Tax Payments			
Includes Current Expense Levies and Others			
in millions of dollars			
School and JVS	FY 2011	FY 2012	FY 2013
School District Reimbursements	\$67.9	\$28.0	\$24.4
JVS Reimbursements	\$6.4	\$1.3	\$0.9
School and JVS Utility Reimbursements	\$74.3	\$29.3	\$25.3
Amount of reimbursement eliminated		\$45.0	\$49.0
Percentage of reimbursement eliminated		60.6%	65.9%
Local Governments	Tax Year 2010	FY 2012	FY 2013
County Utility Reimbursements	\$33.5	\$3.5	\$2.6
Municipality Utility Reimbursements	\$8.6	\$1.2	\$1.0
Township Utility Reimbursements	\$12.1	\$3.9	\$3.4
Special District Utility Reimbursements	\$7.5	\$2.4	\$2.0
"Excess" Local Government Utility Reimbursements	\$7.9	\$0.0	\$0.0
Total Local Government Utility Reimbursements	\$69.6	\$11.0	\$9.0
Amount of reimbursement eliminated		\$58.6	\$60.6
Percentage of reimbursement eliminated		84.2%	87.1%
Total school, JVS, and local government reimbursement eliminated		\$103.6	\$109.6
Percentage of reimbursement eliminated		72.0%	76.2%
Projected current-law gain in "excess" distributions that will not take place		\$16.0	\$18.5
Net GRF gain relative to current law = TY 2010 reimbursement eliminated plus additional excess local government distributions avoided		\$119.6	\$128.1

⁵ In fact, because the GRF amount has actually been a residual after subtracting the dedicated revenues for the replacement funds and half the allocation to the Public Library Fund (PLF), the effective GRF percentage of KWH tax revenues increases by more than shown in Table 3.

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As mentioned earlier, however, despite the generally faster phase-out of utility tax reimbursements under the administration proposal, the phase-out for the relatively few school districts, JVS districts, and local governments that are highly reliant on utility tax replacement payments can extend all the way through 2030.

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