



RESEARCH BRIEF

Financing Suburban Enrollment Increases

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The major school systems in Northern Virginia and Suburban Maryland added 89,066 students between 1995 and 2001, or a 17 percent increase in six years (see Table 1). At an average 25 students per class, this increase required the addition of 3,565 classrooms and at least an equal number of additional teachers. Increases of this magnitude have put area governments under pressure to find financing to build classrooms and to increase operating budgets. The recent recession may add to the problem.

While all the suburban jurisdictions experienced enrollment increases, there were significant differences. The Virginia jurisdictions had almost a 21 percent increase in students compared to 14 percent in the Maryland suburbs. The largest increase in the number of students occurred in Fairfax County, which added 19,764, but the biggest percentage increase was 74.4 percent in Loudoun County. The rate of increase in Northern Virginia went up steadily each year from a 2.5 percent increase in 1996 to almost 4 percent in 2001.

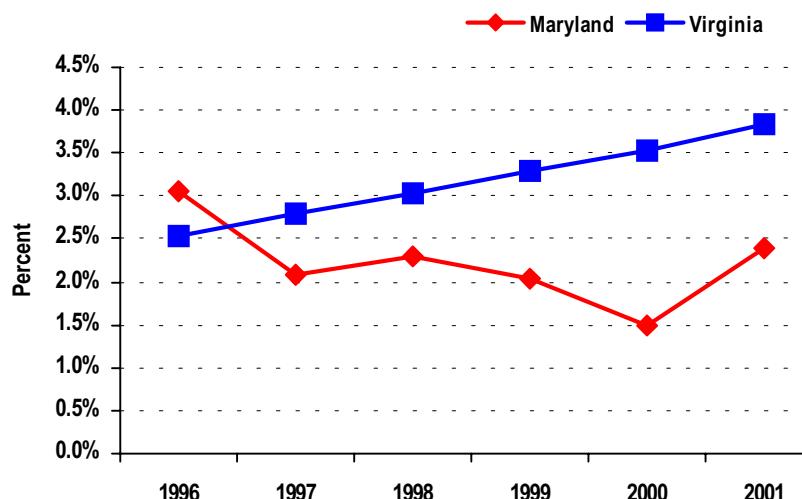
**Table 1: Changes in Public School Enrollments
Major Washington Area Jurisdictions, 1995 to 2001**

	1995 Enrollments	2001 Enrollments	Change	Percent Change	Additional Classrooms
Alexandria	10,044	11,104	1,060	10.6%	42
Arlington	17,178	19,109	1,931	11.2	77
Fairfax County	140,820	160,584	19,764	14.0	791
Loudoun	19,827	34,571	14,744	74.4	590
Pr. William	47,072	58,071	10,999	23.4	440
Total Northern VA	234,941	283,439	48,498	20.6%	1,940
Montgomery	117,082	134,180	17,098	14.6%	684
Pr. George's	118,478	133,723	15,245	12.9	610
Charles	20,419	23,468	3,049	14.9	122
Frederick	31,655	36,885	5,230	16.5	209
Total Suburban MD	287,634	328,256	40,622	14.1%	1,625
Total	522,575	611,695	89,120	17.1%	3,565

Source: DC Public Schools, Maryland Department of Education, and Virginia Department of Education



Chart 1: School Enrollment Changes Northern Virginia Compared to Suburban Maryland



Source: DC Public Schools, Maryland Department of Education, and Virginia Department of Education

(see Chart 1). Suburban Maryland's rate of increase drifted down and was lower in 2001 than 1996.

The Northern Virginia jurisdictions appear to have the greater financing challenges, both because the enrollment increases were larger and because of a more limited local tax structure. In the five large Northern Virginia jurisdictions, almost two-thirds of the money raised locally comes from property taxes. In Suburban Maryland local property taxes account for only about a third of local revenues with local income taxes providing about another third. The remaining third of revenues in both Virginia and Maryland come from fees, charges, fines, and other minor taxes.

Locally raised revenues must provide for a variety of govern-

ment services, but financing rapidly increasing public school enrollments is a major challenge. A comparison of the growth of the principal local tax bases compared to changes in school enrollments from 1996 to 2001 in the Virginia and Maryland suburbs shows substantial differences between the states. For purposes of analysis, it is assumed that tax revenue increases must generally grow at rates comparable to enrollment increases.

Northern Virginia

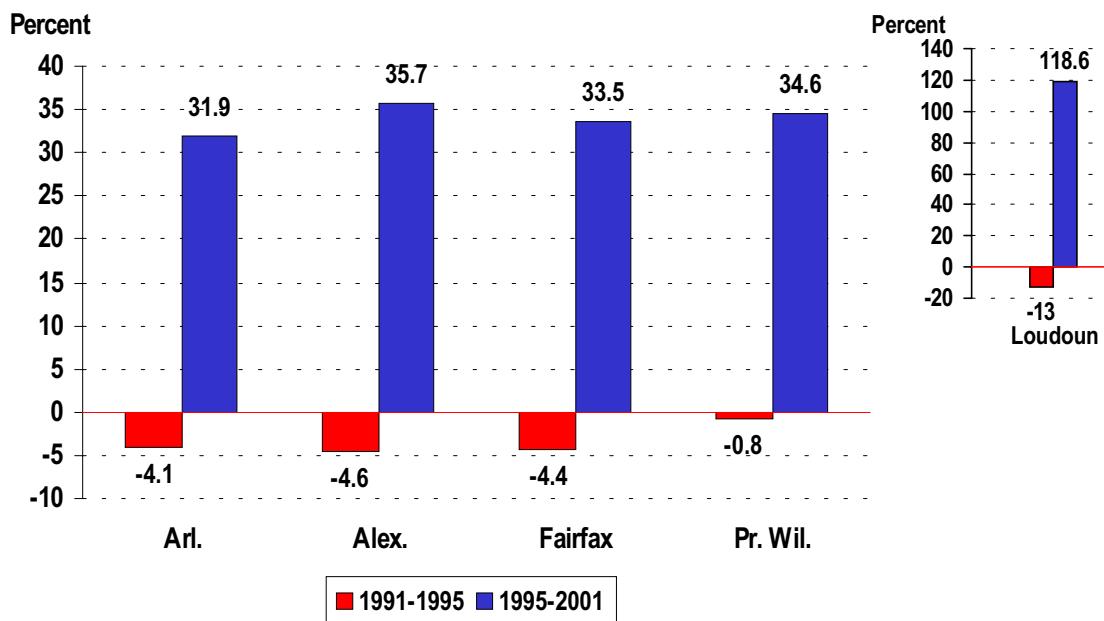
The tax rates on real property in Virginia are not limited by state law and can be set without a voter referendum at whatever level the local legislative body feels is adequate. General obligation bonds, used for financing school construction, are financed by

property taxes, but require a referendum in counties before they can be issued. Referendums for school bonds have historically been approved by comfortable margins. Thus, the only limits on financing school operating and construction costs are self-imposed limits on property tax rates and bond issues. The local governments try to keep the property tax rates unchanged and, instead, rely on increases in the tax bases resulting from new construction and value increases to finance budget growth.

Properties in Virginia are assessed annually and the property tax bases reflect 100 percent of current taxable values. This means that the property tax base is very sensitive to changes in real estate prices. In the recession of the early 1990s the property tax bases in all Northern Virginia jurisdictions declined between 1991 and 1995 (see Chart 2). Severe funding constraints were placed on local school systems, with tax rate increases and budget cuts used to balance their budgets. Then in 1996, after the recession, real estate values increased dramatically in Northern Virginia. Between 1995 and 2001, taxable property values in the five major jurisdictions increased \$53.4 billion or 40.5 percent. Loudoun County had a 119 percent increase and Fairfax County alone had an

Chart 2: Comparison of Recession on Taxable Property Values

Northern Virginia Area Governments



Source: Local governments' Comprehensive Annual Financial Reports

increase of more than \$25 billion.

These increases in value, as large as they were, barely kept pace with the growth of additional students and inflation. After adjusting for inflation, the real increase in property values dropped to 24 percent from 1995 to 2001, barely more than the 20 percent increase in enrollments. In three of the six years from 1996 to 1998, the percentage increase in property tax base did not equal enrollment increases (see Chart 3). The four percent difference, less than an average one percent a year, had to provide for other needs of the governments, as well as school improvements. With schools struggling to cope

with increases in non-English speaking students and special education, many believe the revenue increases have not been sufficient. This may be especially true in Prince William County where the enrollment increase of 23.3 percent was greater than the 18.9 percent increase in the tax base after adjusting for inflation (see Chart 4).

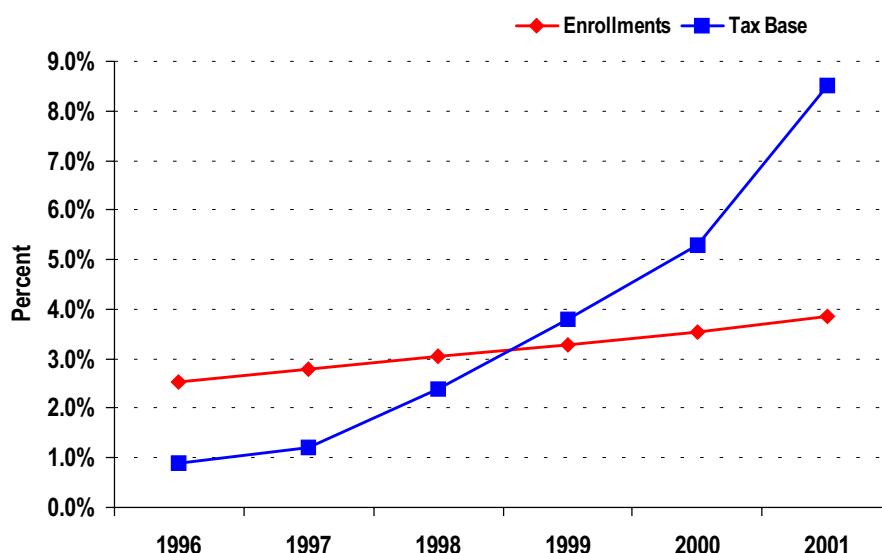
The effects of the current recession on Northern Virginia property values are uncertain, but the values appear unlikely to decline as happened in the recession of the early 1990s. Nevertheless, increases in values for the year immediately ahead may be slowed by the vacancy rates appearing in

commercial real estate. While the nominal real property tax rates are not excessively high in Northern Virginia, the rapid increases in property values have caused tax bills to escalate and created considerable political objections to the heavy reliance on property taxes. An even more serious problem may be a decline in state assistance, including the revenue from a one cent sales tax distributed to local schools, caused by the poor performance of both the state sales and income taxes.

Suburban Maryland

Counties in Maryland may increase the local property tax rates without a referendum, except for Prince George's

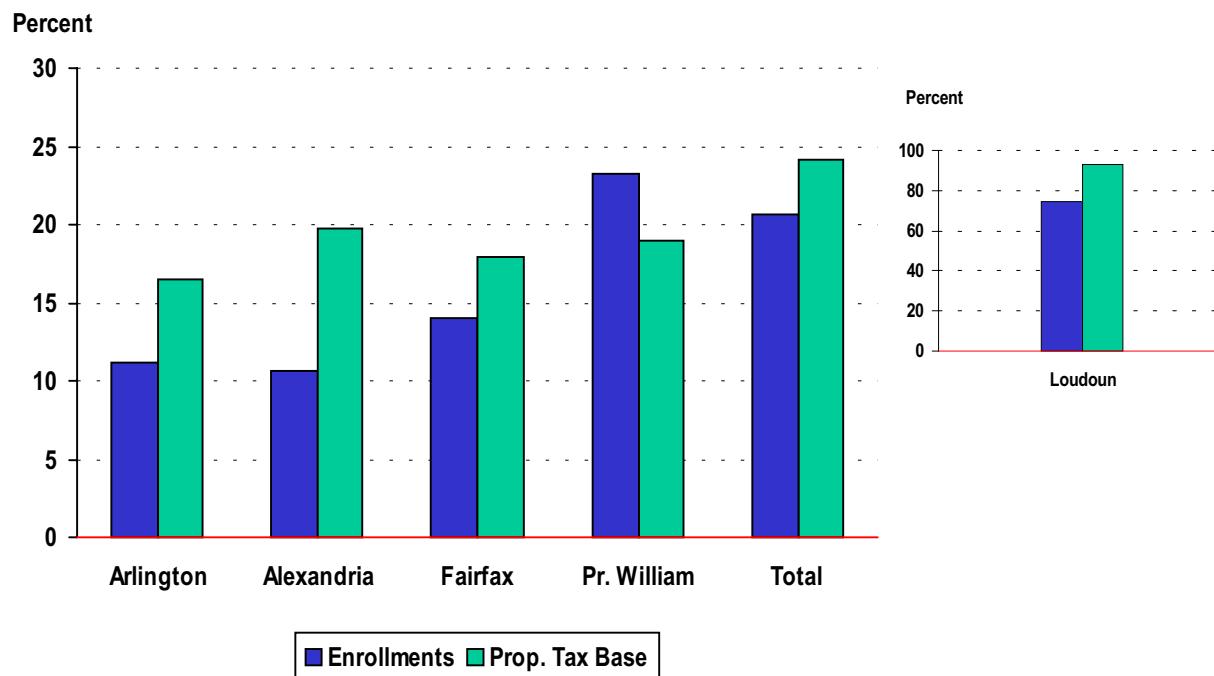
Chart 3: School Enrollment Changes Compared to Property Tax Changes, Northern Virginia Suburbs (Adjusted for Inflation)



Source: Virginia Department of Education and local governments' Comprehensive Annual Financial Reports

County which is at a maximum rate set by a voter approved TRIM amendment. The local property tax in Maryland is less sensitive to changes in real estate prices than the Virginia tax. Properties are assessed once every three years and the assessments are phased in over a following three year period. This means, for example, that one third of the sharp increases in property values that occurred in 2001 will not be fully reflected in assessed values for six years. The result is assessed values increase more slowly than market values when values are increasing and decline more slowly when values are decreasing. The assessed values

Chart 4: School Enrollments Compared to Taxable Values, 1995 - 2001 Northern Virginia (Adjusted for Inflation)



Source: Virginia Department of Education and local governments' Comprehensive Annual Financial Reports

are never based on the actual market values in any year as they are in Virginia.

As a result of the three year assessments, taxable values in the four suburban counties have not reflected the rapid increases in real estate prices in recent years. Assessed values increased 16 percent from 1996 to 2001, but when adjusted for inflation increased only 2.3 percent (see Chart 5) in contrast to the 24.1 percent increase in the Virginia jurisdictions over those years. Values adjusted for inflation actually decreased by two percent over the six year period in Prince George's County. For the one year from 2000 to 2001, a year with area real estate experiencing double digit price increases, the increase in taxable values in Maryland

suburbs was just 3.0 percent.

The property tax in Suburban Maryland clearly has not provided the resources needed for the increased school enrollments. Instead, Maryland local jurisdictions have depended on the local personal income tax that is "piggy-backed" on the state tax. Revenues from this tax have easily picked up the slack left by the sluggish property tax base. The income tax revenues for the four Maryland suburban counties combined increased 61.7 percent from 1995 to 2001. Even after adjusting for inflation, the increase was still 42.8 percent. There were notable differences among the jurisdictions, with Prince George's County income tax increasing only 18.6 percent after adjusting for inflation.

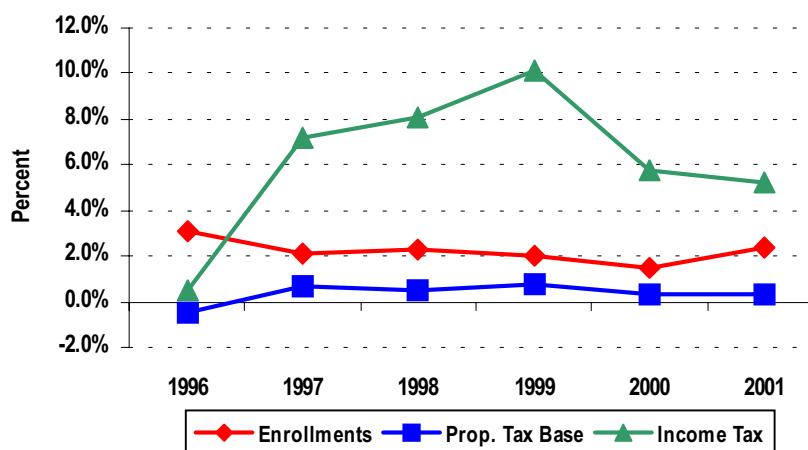
Nevertheless, the combined changes in property tax base, and the local income tax provided a sufficient basis for financing the costs of increased enrollments in each jurisdiction (see Chart 6).

The downside on the use of the personal income tax to support local education is its sensitivity to economic downturns. Suburban income tax revenues, adjusted for inflation, went from a half percent increase in 1996 at the end of the previous recession, to a peak 10.1 percent increase in 1999, and then down to 5.2 percent in 2001 as the recession commenced. It is not yet possible to assess the full effects of the current recession.

Conclusions

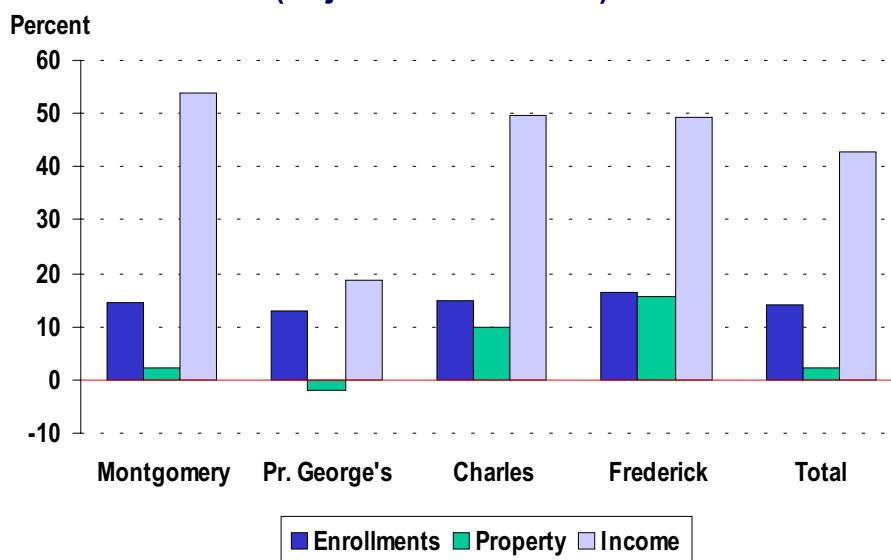
A comparison of the Virginia property tax base, the Maryland property tax base, and the Maryland local income tax revenues, all adjusted for inflation, shows a remarkable difference in performance over the six year period (see Chart 7). As the area came out of the recession in the mid 1990s, the income tax soared, but it has slowed with the current recession. In Virginia, the property tax was slow to grow in the mid 1990s, but has been growing rapidly in recent years, despite the new recession. The Maryland property tax, after recovering from the recession in the

Chart 5: School Enrollment Changes Compared to Property Tax and Income Tax Changes in Suburban Maryland (Adjusted for Inflation)



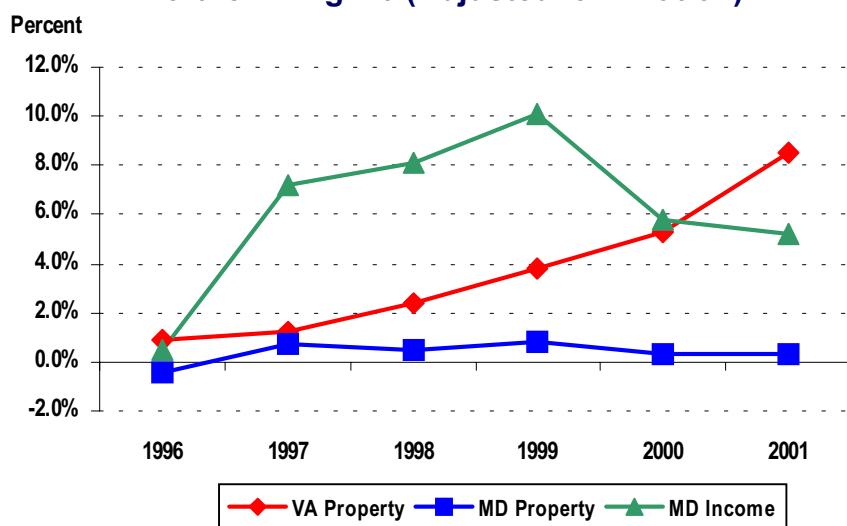
Source: Virginia Department of Education and local governments' Comprehensive Annual Financial Reports

**Chart 6: School Enrollments Compared to
Taxable Values and Income Taxes, 1995 - 2001,
(Adjusted for Inflation)**



Source: Maryland Department of Education and local governments' Comprehensive Annual Financial Reports

**Chart 7: Property Tax Assessed Value and Maryland
Income Tax Changes, Suburban Maryland and
Northern Virginia (Adjusted for Inflation)**



Source: Maryland Department of Education, Virginia Department of Education and local governments' Comprehensive Annual Financial Reports

early 1990s has experienced virtually no annual growth.

Which local tax is better for financing the growing school enrollments? It depends on the local economy and what is considered the most important features in a tax. The Virginia suburbs experienced an immense growth in school enrollments since 1996 that have been financed by soaring real estate values. A slowing growth rate in property values caused by the recession could cause sharp budget reductions or property tax rate increases. The heavy local dependence in Virginia on a property tax, closely tied to changes in real estate values, provides an unstable and unpopular source of financing for schools.

The Maryland suburbs have had a slower and uneven rate of increase in enrollments. These increases have been financed by a relatively stable property tax base and sharply higher income tax revenues. The income tax is closely tied to the performance of the local economy and is subject to wide variations in revenue growth. However, when the income tax is coupled with the stable property tax base, it provides a good diversity in local revenues.

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