State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

Agency of Administration

November 30, 2012

Rep. Shap Smith, Speaker of the House
Sen. John Campbell, President Pro Tempore
Vermont State House
115 State Street
Montpelier, VT 05633-0004

Dear Speaker Smith and President Pro Tempore Campbell,

As you know, 32 V.S.A. §5402b(1) and (2) requires the Commissioner of Taxes, after consultation with the Department of Education, the Secretary of Administration and the Joint Fiscal Office, to recommend adjustments to the statewide education tax rates by December 1st, if the balance in the education fund stabilization reserve is projected to exceed five percent or fall short of three and one-half percent. New legislation last session also requires that the calculation be stated as a "dollar equivalent", expressing the amount of per pupil spending that a $1.00 homestead property tax rate supports.

As usual, staff from the Department of Taxes, Department of Finance and Management, Department of Education, and Joint Fiscal Office has prepared consensus forecasts on various components of the Education Fund Operating Statement for FY14. The broad perspective is clear. The number of PreK-12 students continues to fall in Vermont, as do property values. Unless school districts trim expenses commensurately, the amount of spending per pupil rises and triggers property rate increases.

In fact, we see that despite healthy growth in non-property tax revenue available to the Education Fund next year, the statewide property rates still will have to be raised, if spending rises as forecast. Staff projects an *additional* $10M in dedicated sales and use tax revenue, $8.2M in general fund transfer, and $1.9M in purchase and use and lottery receipts over FY13. There also is an estimated $23M of unallocated/unreserved funds that are available as carryforward in FY14. However, this infusion of $43.1M in non-property tax revenue is overshadowed by a projected 4.8% growth in education spending.

The following highlights some of the noteworthy upward and downward pressures.

- *Grand List:* The statewide grand list is projected to decline in value once again from FY13. This downward trend is slowing and should flatten out next year. In

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the meantime, lower values mean that last year's rates on property will raise less money to spend per pupil.

- *Property Tax Adjustments:* Forecasting adjustments for income sensitized taxpayers has been complicated by year-to-year changes in the components of household income. In FY12 and FY13 actual adjustments were below forecast. Under current law assumptions, FY14 adjustments are projected at $142.8M.

- *School Spending:* At this time last year, total education spending for FY13 was forecasted to rise 1.7%. The actual rate of growth in spending came in higher at 3%. This was despite the Governor's explanation that only by holding spending flat could school boards and local voters avoid rate increases. This year, various projections lead to an overall forecast that spending may increase 4.8%. The cost of the local share of special education is projected to rise 7%. These increases are discussed further below.

- *Equalized Pupil Count*: The number of equalized pupils is projected to decline by approximately 670, from 90,606 to 89,940. This is despite the fact that schools are encouraged to add critical Pre-K sections; without those Pre-K pupils the drop would be even more dramatic.

- *Base Education Amount (16 V.S.A. §4011(b)):* The base education amount per pupil had been frozen at $8,544 for three years through FY12. Section 4011(b) requires that the base education amount be reset annually incorporating inflation for all the intervening years since 2005 using the State and Local Government ("S&LG") Price Index. Under this formula, the base amount is set to increase from $8,723 to $9,151 for FY14. As noted below, it would be more prudent and reflective of economic reality to grow this amount by only one year's inflation, the approach adopted for FY13.

- *General Fund Transfer:* Using the S&LG price index, the general fund transfer is set to increase $8.2M.

- *Dedicated Sales & Use Tax (Act 143, §56)*: This section permanently increased the allocation of sales and use tax to the Education Fund. As a consequence, $10M more in this non-property tax revenue will be shifted from the General Fund next year.

Reflecting these and other factors, the consensus forecast is that the balance in the stabilization reserve would fall below three and one half percent under current law at the current statewide education tax rates of 0.89 and $1.38, and therefore 32 V.S.A. §5402b(2) requires a recommendation that the base homestead property tax rates be increased. To fill the maximum reserve at 5% under current law requires a $0.05 increase in the base homestead property tax rate to $0.94, and a like increase in the uniform non-homestead property tax rate to $1.43. The 1.8% base homestead income rate remains at its floor pursuant to §5402b(b). It must be noted that both the $0.94 and 1.8% base homestead rates would be subject to adjustment based on local spending decisions. In FY13 the average equalized homestead property rate is $1.32. Act 143, §40 requires that the Commissioner also calculate the dollar equivalent of revenue per equalized pupil that would result under a homestead property tax rate of $1.00. Incorporating all of the current law assumptions, the dollar equivalent is $9,735.[1]

Although §5402b is prescriptive with respect to the recommendation of the Commissioner of Taxes under current law and forecasts, it is entirely possible to temper any increase in the statewide base rates for FY14. The Governor recommends the following steps to ensure that will be the case:

1) Similar to last year, the Governor recommends that notwithstanding 16 V.S.A. §4011(b), the base education amount should only be increased by 2.2%, representing one year of inflation. In this scenario, the base education amount per pupil rises from $8,723 to $8,915. To allow the base education amount instead to jump by multiple years of inflation to $9,151 presents a skewed picture of our spending capacity per pupil that is out of line with economic and budgetary realities, and is likely not what the Legislature had in mind when they held the base education amount level for consecutive years. Holding the base education amount to $8,915 will limit the statewide property tax rate increases to $0.03.[2]

2) School spending growth must be held down. This is imperative because local spending decisions are a primary driver determining whether local and statewide education taxes go up or down. As noted above, spending increases are projected at 4.8%. Instead, if spending stays flat, then at the $8,915 base payment no increase in the statewide property tax is necessary.[3] If spending were to track the S&LG Price Index at 2.2%, then at the $8,915 base payment the statewide property tax increase would be limited to $0.02.

   Our funding formula is not always transparent with respect to the fundamental question of who pays for spending increases, and there was a healthy discussion last year of the ramifications of tweaking various components of our funding formula, such as the statewide rates and the amount of non-property tax revenue. But these discussions cannot

[1] Section 40 suggests that the dollar equivalent rate assume a 2.0% base homestead income rate. This is not possible in the current year, since as noted above, the base income rate remains at 1.8%. Under the current formulation, the base income rate will not rise from 1.8% unless the base property rate rises to $0.99.

[2] The $0.03 rate at the $8,915 base payment level results in a projected 4.6% reserve.

[3] Again, a small shortfall results in a projected reserve of 4.6% under this scenario.

obscure the obvious – someone is paying if school spending continues to grow even as student populations fall, and this spending is at the expense of other pressing state needs.

This year, schools are projecting growth in spending related to agreed upon salary increases and health premium increases. Salaries are projected to increase 2.5% for FY14, which at current projected staffing levels costs over $17M. After two flat years, insurance premiums also are estimated to rise between 10-15%; a 13.5% increase at current projected staffing levels costs over $31M. Personnel costs are often referred to as "fixed" once compensation levels are set in contract. However, we cannot lose sight of the fact that the number of educators in our schools can be adjusted to balance higher compensation costs. This is particularly appropriate and necessary when our number of students continues to fall. With special education costs at the local level projected to rise 7%, districts must explore all alternatives to serve this population at an affordable cost.

Earlier this year we received a report on our education system from Picus and Associates. That report confirmed that Vermont has experienced very high education spending growth. In fact, our spending levels are among the highest in the nation, driven in part because we have some of the lowest ratios of students to educators. The report highlights how Vermont has continued to grow its spending, and added teachers, administrators and support staff, even as the state has experienced one of the nation's most precipitous decline in students. The report shows that Vermont students score relatively high on standardized tests, but at the same time suggests that in comparison to other states we might achieve similar results with a less expensive mix of resources. We need to engage in these discussions.

We respect local control, but must acknowledge that within a statewide funding system the spending increases in our larger school districts reverberate loudly across the state. The entire state benefits when these districts are doing everything possible to maximize their economies of scale. At the same time, many communities value their smaller expensive schools, again a matter of local control that with our funding mechanism is felt across the state. We all benefit by being open to bold new education futures for our students, ensuring both quality and affordability.

This letter is required by statute in order to publish the projected statewide education tax rates based on current law and forecasts before the legislative session. It marks the start of the conversation with the legislature as school boards are putting together the budgets that will be presented to local voters at Town Meeting in March. This Administration is committed to working with legislators and local leaders towards educational excellence that is affordable for our taxpayers. In the meantime, I extend my thanks to staff for the work in assembling the data necessary for the projections.

Sincerely yours,

Mary N Peterson

Mary Peterson
Commissioner, Department of Taxes

cc: Jeb Spaulding, Secretary, Agency of Administration
Jim Reardon, Commissioner, Department of Finance and Management
Bill Talbott, Chief Financial Officer, Department of Education
Rep. Janet Ancel
Sen. Ann Cummings
Rep. Johannah Leddy Donovan
Sen. Kevin Mullin
Stephen Klein, Joint Fiscal Office
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