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

Agency of Administration

December 1, 2011

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. Section 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.

The Governor has asked me to make clear his goal and expectation that, working together with local education officials and the Legislature, we will maintain the statewide education tax rates for next year at the same level as this year, while aiming to fully fund the stabilization reserve at five percent. Later in this letter, I will explain the two steps necessary for this to take place.

As usual, staff from the Department of Taxes, Department of Finance and Management, Department of Education, and Joint Fiscal Office have prepared consensus forecasts on various components of the Education Fund Outlook for FY13, and note the following pressures:

- *Grand List:* The statewide grand list is projected to decline in value from FY12. This is a continuation of the downward trend related to the residential and commercial real estate market that likely will impact the fund for two more years. All else being equal, falling values create an upward pressure on property tax rates in order to fund education spending at the same level.

- *Tropical Storm Irene:* Damage and rebuilding from Tropical Storm Irene are expected to balance out without any additional negative effect on the overall statewide grand list value for FY13. Legislation that would give the Commissioner authority to reimburse towns for abatements of FY12 education taxes currently is estimated to cost in the range of $2-4M, which would be covered by the FY12 surplus. Given that the bill has not passed the General Assembly, reimbursements are not factored into current law projections at this time.

- *Property Tax Adjustments:* Adjustments for income sensitized taxpayers in FY11 ended up below forecast. Staff analysis suggests that this was the result of the new provision that disallowed certain federal adjustments to income on Line Q when calculating Household Income. The data indicate that the change both disqualified some homeowners from eligibility and lowered the adjustment for others. However, for FY13 taxpayers will be allowed the federal deduction for self- employment health insurance, which is believed to have comprised a significant share of the Line Q impact. Therefore, the total for FY13 adjustments is forecast to rise slightly over the FY12 adjustment estimate. (It also should be noted for FY14 the provisions which increase the effect of interest and dividend income on overall Household Income and which limit adjustments to the first $500,000 in home value are set to sunset).

- *School Spending:* Based on DOE's preliminary inquiries to school districts, the education spending growth rate is projected at 1.7% for FY13. This follows a reduction in education spending for FY11 and FY12, although school districts had access to American Recovery and Reinvestment Act ("ARRA") federal monies in those years.

- *Base Education Amount (16 VSA §4011(b)):* The base education amount per pupil has been frozen at $8544 for three years through FY12. Using the State and Local Government ("S&LG") Price Index, the base amount is set to increase to $8891 for FY13.

- *General Fund Transfer:* After several years in which the General Fund transfer was impacted by several factors, including the availability of ARRA funds, the base was reset for FY12. Using the S&LG price index, the general fund transfer is set to increase slightly over $6M.

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 without an increase in the statewide education tax rates, and therefore 32 V.S.A. Section 5402b(2) requires a recommendation that the base homestead property tax rate be increased. Although a $0.01 increase might satisfy the minimum requirements of that section by meeting the minimum reserve, to fill the maximum reserve at 5% requires a $0.02 increase in the homestead base rate to $0.89, and a like increase in the uniform non-homestead property tax rate to $1.38. The 1.8% base homestead income rate remains at its floor pursuant to Section 5402b(b). It must be noted that both the $0.89 and 1.8% base homestead rates would be subject to adjustment based on local spending decisions. In FY12 the average equalized homestead property rate is $1.25.

Although Section 5402b is prescriptive with respect to the recommendation of the Commissioner of Taxes under current law and forecasts, it is entirely possible to avoid any increase in the base rates for FY13. The Governor recommends the following two steps to ensure that will be the case:

1) School spending should be held level next year. That is important because local spending decisions are a primary driver determining whether local and statewide education taxes go up or down. The Governor is most appreciative of the time and energy local leaders have devoted to providing quality educational opportunities in a cost constrained environment. The fact that, overall, school spending has been relatively level for the past two years demonstrates that school boards, educators, and voters have been diligent in keeping costs in line. With student enrollments continuing to decline and a new trend showing the number of educators in our schools declining, Vermont should be able to hold overall spending level for the next school year.

   According to the most recent elementary and secondary public school enrollment report from the Vermont Department of Education, school year 2010/11 was the fourteenth consecutive year of declining enrollment. Vermont has experienced a 15% decrease in enrollment, since hitting a peak of 106,341 students in school year 1996/97. School year 2010/11 saw a further decrease of 950 students in elementary/secondary public school enrollment. This trend is projected to continue, albeit at a slower pace. More importantly, the number of educators has now begun to decline as well. This is a trend that has been predicted for many years and appears to be taking hold now. According to the most recent Vermont Department of Education staff/salary report, the full time equivalent (FTE) teacher and support staff totals for school year 2010/11 decreased by more than 300 from school year 2009/10. According to actuarial reports provided by the Office of the State Treasurer, between school year 2008/09 and 2010/11, the number of educators in our public schools dropped by over 650, from 10,799 to 10,123.

2) Increase the base education amount by 2.1%, representing one year of inflation. Since this factor has been frozen for three years, 16 VSA §4011(b), if not amended, will require the base education amount to jump by three years of inflation. The Governor believes increasing the base education amount by one year of inflation, 2.1%, would be prudent, appropriate, and consistent with the intent of prior actions by the General Assembly.

If these two steps are realized, there will be no increase in statewide education tax rates next year. The Administration looks forward to working with local educational leaders and the

Legislature to ensure that result. Together we can continue to deliver first class educational opportunities for Vermont students in a manner that is affordable for our citizens.

Sincerely yours,

Mary

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
Stephen Klein, Joint Fiscal Office