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

Agency of Administration

December 1, 2015

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:

The Commissioner of Taxes, after consultation with the Agency of Education (AOE), the Secretary of Administration and the Joint Fiscal Office (JFO), is required by 32 V.S.A. § 5402b to calculate and forecast a property dollar equivalent yield, an income dollar equivalent yield, and a nonresidential tax rate by December 1. This letter is submitted in fulfillment of the statutory obligation. The Department of Taxes, Department of Finance and Management, Agency of Education, and the Joint Fiscal Office prepared consensus forecasts on various components of the Education Fund Operating Statement for Fiscal Year (FY) 2017 so that the required analysis could be performed.

Many thanks go to these departments for their hard work. As discussed below, the construct of the statutory exercise has changed significantly. Staff has done its best to fulfill the statutory intent of these changes, but it must be noted that the calculations and forecasts are complex. The legislature will set the yields and rate that will be the foundation of education tax bills this year during the upcoming session.

Statutory Charge and Act 46 Changes

Since 2003, this letter communicated three education tax rates: a rate on non-residential property, a rate on homestead property, and a rate for those paying based on income. The letter began the conversation of whether the base education tax rates needed to be increased to cover projected spending in the coming year.

Act 46 of 2015 changed the structure of this letter. The homestead property rate is set in statute at $1.00 per $100 of equalized education property value for FY2017 and all subsequent years. 32 V.S.A. § 5402(a)(2). Similarly, the rate for those paying on income is 2% beginning in FY2017.

32 V.S.A. § 6066(a)(2). This year's letter is an introduction to two numbers that are new to the education funding landscape: a "property dollar equivalent yield" and an "income dollar equivalent yield." These two numbers are designed to illustrate how much per pupil spending the $1.00 and 2% education property tax rates will support in the coming year. How much each district chooses to spend per pupil compared to the enacted yields will determine its locally adjusted rates on homestead value and income. The non-residential rate will continue to be communicated as a traditional rate and its calculation is tied to the yields for purposes of this letter.

The $1.00 and 2% rates will yield different amounts from year to year because of the various economic forces that affect the Education Fund, including Vermont property values, household incomes, and anticipated education spending. A district's residential education tax rates will be its per-pupil spending divided by the property dollar equivalent yield or the income dollar equivalent yield.[1]

Current Forecast of Education Tax Components

The forecasts in this letter still depend on total anticipated education fund spending and total pupil count.

Total Equalized Pupil Count

FY15 (Final)	FY16 (Preliminary)	FY17 (Projection)
89,257	89,163	88,572

Total Education Fund Spending (millions)

FY15 (Final)	FY16 (Preliminary)	FY17 (Projection)
1,514	1,552	1,582

Source: AoE

[1] Previously, a district's education tax rates were its per-pupil spending divided by the statewide base amount multiplied by the base education tax rate set in statute. The statewide base amount was set at $6,800 in FY2005 and grew according to a NEEP (New England Economic Project) cumulative price index in subsequent years. 16 V.S.A. § 4011(b). Beginning with the FY2017 rates, the statewide base amount from 2005 is no longer a factor in determining tax rates.

It should be noted that the term "yield" is not used in the same manner as in a traditional property tax equation. For example, to calculate the per pupil spending that the $1.00 (per $100.00) of homestead property rate "yields" one might think it would be solved by multiplying 1% by the total homestead grand list, and then dividing by the number of equalized pupils, thus solving for the yield per pupil. However, that is not how either the property yield or the income yield is determined. Both "yields" in this education formula are sensitive to a variety of factors, and heavily influenced by the anticipated amount of education spending around Vermont.

Unfortunately, the number of pupils continues to decline in Vermont even with the expansion of pre-kindergarten programs. The state is projected to lose 591 equalized pupils next year. Total education fund spending is projected to increase by 2.5%.

The amount of total education fund expenses remaining after accounting for the general fund transfer ($303.6M), sales and use ($138M), purchase and use (35.6M), and all other sources is what needs to be generated through the education taxes.

Calculating Yields

As discussed earlier, this is the first year with a property dollar equivalent yield on a $1.00 rate and an income dollar equivalent yield on a 2% rate. In prior years, this letter would forecast the rates themselves. Now that the rates for homestead and income are set in statute, this letter forecasts how much statewide per-pupil spending (yield) the statutory rates will support in the coming year.

Previous Calculation Process		
Rates	Base Amount	Total Spending
?		

FY2017 Calculation Process		
Rates	Yields	Total Spending
	?	

The process still depends on forecasting the independent spending decisions of every town, the equalized education grand list of every town, and incomes. In past years, there was an excess spending threshold that few towns exceeded. 32 V.S.A. § 5401(12). This year there are caps on allowable growth that are different for every town and are based on per pupil spending from last year. Sec. 37 of Act 46. A higher spending town is allowed less growth, whereas a lower spending town is allowed more. Additionally, districts that vote to merge are afforded reductions in their tax rates. These growth constraints and tax incentives are a result of Act 46, and add another level of complexity to the yield/rate-setting process.

5402b(a)(2) Mandated Forecast

As defined in statute, the homestead education property tax rate for FY2017, and all years forward, will be $1.00 and the homestead income rate will be 2%. Act 46 directs the Commissioner to calculate the two yields and the non-residential tax rate as of December 1 by assuming that the "percentage change in the median education tax bill" of all three types of payers is equal. 32 V.S.A. §5402b(a)(4). However, it is the legislature that ultimately sets the yield. 32 V.S.A. §5402b(b).

In any given year, the median bill, that is, the bill literally at the midpoint in the range for each of the payer types, will depend on a number of factors, including property sizes and improvements, property appreciation, income growth, local rate adjustments for spending on residential rates. The total revenue raised from each of the three groups depends both on the growth in the total bases of income and property and the rates applied. Staff derived the calculations herein by estimating the average growth in each of the bases and then calculating yields/rate so that the change in the average bill for each of the three types of taxpayers would increase by the same percentage, while raising enough money to fill the reserve. Under this scenario, the average homestead rate grows slightly more because the average homestead property is estimated to experience the least percentage of growth in value. The legislature will need to thoroughly vet this new calculation to determine if it meets the intent of §5402b(a)(4) prior to setting the yields and rate.

With all contributing factors as they appear on December 1, 2015, the property yield, income yield, and non-residential rate are forecasted as followed:

FY 17 Base Rates and Yields		
	Base Rate	**Yield**
Homestead Property	$1.00	**$9,955**
Income	2.00%	**$11,157**
Non-Residential Property	**$1.538**	-------

At this time, these forecasted yield amounts and the non-residential rate are anticipated to generate enough tax revenue to pay for the education spending that remains after the other sources are taken into account and to maintain the statutory reserves at 5.00%.[2]

Because of the change from rates to yields, the best way to compare this year to the previous two years is to look at the average rate forecasted to be paid by the different types of taxpayers:

[2] This forecast relies on devoting all of the reverted funds from prior years to increase the yields for everyone. Alternative approaches include not using all of the savings in reserve this year but instead spreading it out over the next few years, and/or only applying the funds strategically to support the goals of Act 46.

Average Tax Rates	FY2015	FY2016 (preliminary)	FY2017 (projected)[3]
Homestead Property	$1.50	$1.525	$1.535
Income	2.72%	2.74%	2.72%
Non-Residential Property	$1.515	$1.535	$1.538

The average homestead rate is forecast to be one cent higher this year, while the average income rate decreases slightly. The average bill (rate applied to property or income) is projected to increase by the same percentage (1.12%) for all three types of payers. In any given year, there is a broad range of equalized homestead tax rates around Vermont. In FY2016 homestead taxpayers in the majority of towns paid near the average rates in the previous table, but many paid less and many paid more depending on local spending decisions. Due to changes from Act 46, FY2017 projects to have even more variation in the rates taxpayers actually pay. Rates will be influenced by the allowable growth percentage, as well as accelerated merger incentives.

Working with Yields

The example of a district which spends the exact same amount per pupil in FY2016 and 2017 shows how the locally adjusted rates are derived (without reference to the allowable growth percentage or any merger incentive).

FY2016 Education Tax Rate Calculation:

Per Pupil Spending		Base Per Pupil Amount		Statewide Homestead Rate		Tax Rate
$15,000	÷	$9,459	x	$0.99	=	$1.570

FY2017 Education Tax Rate Calculation:

Per Pupil Spending		**Property Yield**		Statewide Homestead Rate		Tax Rate
$15,000	÷	$9,955	x	$1.00	=	$1.507

It is important to note that this town's homestead tax rate went down from FY2016 to FY2017, even though the statewide base rate appeared to increase by a penny (from 0.99 to 1.00).

The changes to the calculation for someone paying education taxes based on income are basically the same. Here's an example for someone in that same town, but who is paying the income rate:

[3] If the forecasts in this letter are enacted, these are the projected average rates paid by the three different types of taxpayers.

FY2016 Education Tax Rate Calculation:

Per Pupil Spending		Base Per Pupil Amount		Statewide Income Rate		Tax Rate
$15,000	÷	$9,459	x	1.8%	=	2.854%

FY2017 Education Tax Rate Calculation:

Per Pupil Spending		**Income Yield**		Statewide Income Rate		Tax Rate
$15,000	÷	$11,157	x	2.0%	=	2.689%

This taxpayer's tax rate also went down even though the statewide base income rate appeared to increase from 1.8% to 2%.[4]

Local Homestead Tax Rates Determined After Budget Votes

Many assumptions inform these yield projections, but perhaps none is more important than the level of spending per pupil that local districts ultimately settle upon in budget votes this spring. The level of spending in each district contributes to the amount needed statewide. If districts (cumulatively) can hold down spending per pupil, then the statewide yields could be set higher, leading to lower local rates across the state. In that case, the non-residential rate should be set lower as well.

Act 46 attempted to make the connection between education spending and tax rates clearer by changing the budget language districts should use when presenting their budgets (Sec. 33 of Act 46, 16 V.S.A. § 563). This new language includes the total budget for the upcoming fiscal year, as well as what the education spending will be per pupil. It also includes a percentage change from the current year to the upcoming fiscal year for the spending per pupil. Since per pupil spending is the driver for local homestead tax rates and rates for folks paying based on income, this change in budget language is designed to allow for a better understanding of how local budget votes will impact the local rates. [5]

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[4] As in past years, the state adjustment for the difference between what the taxpayer would have paid based on property and the percentage of their income from the rate above will not be applied until their FY2018 property tax bill.

[5] Every town's education tax rate on property also is impacted by a CLA. The CLA is a number computed by the state in order to "equalize" the grand list. If property in a town is generally selling for more than its list price, the CLA will be less than 100%. If it is selling for less than list price, the CLA will be more than 100%. The CLAs are necessary because some towns have reappraised recently (bringing their listed property values close to fair market value) and others have not. A town's education rate gets divided by the CLA, so a town where the grand list is generally below fair market value (CLA less than 100%) will see its education tax rate adjusted up. The median CLA is expected to be 102.21% this year, so more than half of the towns should see an adjustment downward of their education tax rates.

Conclusion

Act 46 of 2015 was a comprehensive piece of legislation advancing many changes to how Vermont School Districts should be structured in the 21st century. The goal of the legislation was to broaden and improve the educational experience of students in every region of the state while providing needed relief to Vermont's taxpayers. It is too early to know what the long-term impact of these changes will be on education taxes. The yields forecasted in this letter would suggest that average tax bills may rise a little over 1% in the coming year, however the yields and corresponding non-residential tax rates will be set by the legislature based on updated information during the session.

Sincerely yours,

Mary N Peterson

Mary Peterson
Commissioner, Department of Taxes

cc: Justin Johnson, Secretary, Agency of Administration
Rebecca Holcombe, Secretary, Agency of Education
Andy Pallito, Commissioner, Department of Finance and Management
Rep. Janet Ancel
Sen. Tim Ashe
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