PHILIP B. SCOTT
Governor

State of Vermont
OFFICE OF THE GOVERNOR

May 22, 2018

The Honorable Mitzi Johnson, Speaker of the House
The Honorable Tim Ashe, President Pro Tempore
115 State Street
Montpelier, VT 05633

Dear Speaker Johnson and Senator Ashe:

I am writing in follow-up to our meetings in which we discussed the logistical goals of the Special Session to convene tomorrow. As a result, the Speaker requested that, in addition to my letter notifying my intent to call a special session, I outline my concerns with the budget bill (H.924) and the tax bill (H.911) in additional detail. This information is provided below with the hope it will help us to achieve an expedient resolution in the one area where there is not yet agreement.

My primary objection to the bills – and the reason I've called the Special Session – is that together they result in an unnecessary and avoidable $33 million property tax increase on Vermonters. We have, in this fiscal year, about $160 million more in revenue than last year. This additional revenue breaks down as follows:

- $82 million more from organic economic growth;
- $34 million in unanticipated funds from the Attorney General's tobacco settlement; and
- $44 million in surplus revenue recently added to the budget.

As you know, I cannot support raising statewide property tax rates – especially in a year when we have other options. Homeowners, those who rent homes and apartments, employers of all types and sizes – everyone who lives, works and invests in Vermont – deserves a more stable, predictable and affordable property tax system.

To be clear: if the Legislature wants to raise property taxes at a time when we have significant surplus revenue, it will have to override a veto.

However, I believe we are much closer to an agreement than the political rhetoric and corresponding media coverage indicate. I've detailed how close we are – and how we can very easily reach a true consensus – in more detail further below.

Working Family Taxpayer Protection Act (H. 911, Sections 1-9)
When it became clear that the Federal Tax Cuts and Jobs Act had a widespread financial impact on Vermonters, I proposed my Working Family Taxpayer Protection Act in February. The goal of this plan

was to return to Vermonters the net $30 million State personal income tax increase the federal changes would cause. The hardest hit by the federal changes were middle income Vermonters with children.

I am grateful that H.911, as passed, includes nearly every element of my proposal. The major difference is the inclusion of a $20,000 cap on the five percent charitable contribution tax credit; as you may recall, I recommended a five percent credit without a dollar limit. I believe, over time, the Legislature may want to reconsider this cap, given the impact it may have on large charitable contributions to Vermont's non-profit sector.

Nevertheless, the tax credit will provide an incentive to those 90 percent of Vermonters who are not expected to itemize deductions this coming year and is a new tax advantage to all Vermonters, whether they itemize or not.

Altogether, this portion of H.911 achieves my goal of moderating the tax burden, with an emphasis on low to moderate income Vermonters who receive Social Security. It also promotes charitable giving by reducing the tax liability of those who choose to give. I respect and appreciate the Legislature's work in this area and I will not pursue any changes to the Working Family Protection Act sections of H. 911 during the Special Session.

Five-Year Plan to Stabilize Education Tax Rates and Reinvest Savings

Earlier this month, in an effort to reach a consensus, I presented to Senate and House leadership a comprehensive five-year plan, built on the many ideas and concepts that have been presented throughout this Biennium. None of the core elements of my proposal were new. This plan would:

- Fully fund the school budgets local voters have approved for next year;
- Close the FY19 Education Fund gap and prevent recurring deficits;
- Stabilize statewide property tax rates for five years;
- Generate almost $300 million in total net savings over five years that can be reinvested in more and better early education, K-12 education, technical education, higher education opportunities and lower tax rates;
- Allow education spending to grow sustainably each year based on the average projected increase (the consensus forecast) in grand list value of 3.25 percent; and
- Set Vermont on a stable and predictable five-year trajectory allowing local school districts to take full advantage of the governance changes made under Act 46.

The plan achieves gross savings over five years of over $450 million if all the components of the plan are passed as outlined. It is important to know that three have already been achieved and a fourth was being considered in the Senate Education Committee before adjournment:

- Special Education Census Model: changes to the method by which we deliver special education services in Vermont as passed in H.897, *An act relating to enhancing the effectiveness, availability, and equity of services provided to students who require additional support*;

- Staff-to-Student Ratios: savings through natural attrition (vacancies and retirements) by filling only four of five of those expected to occur over the next five years aided by the work and recommendations of a student-to-staff ratios task force contained in Section 17 of H.911 (note: one stated goal of Act 46 is improved ratios);
- Statewide school employee health care benefit: a statewide school employee health care contract—if this cannot be achieved so all stakeholders agree this special session, the benefit should be put in session law for two years providing time for a viable plan supported by all the stakeholders to be achieved in the next Biennium; and
- Property Tax Adjustments: decrease the maximum house site value from $500,000 to $400,000 (H.911, Section 14); reform the property tax adjustment calculation for new homesteads after July 1, 2018; lower the excess spending threshold gradually from 121 percent to 110 percent over the next five years.

As you can see, we are very close. With a little more constructive dialogue during the Special Session, I am confident we can get a full package to the finish line that, informed by the additional perspective below, meets my goals and yours.

Below is what remains to be done, from my point of view.

Property Tax Yield, Adjustments and Structure (H.911, Sections 10-16)
My primary objection to the property tax provisions of H.911 are the resulting property tax rate increases on both residential and non-residential property. The yield produces an average homestead tax rate of $1.526, a 2.6 cents property tax increase from 2018 rates. The non-residential rate is set at $1.59, an increase of 5.5 cents from 2018.

Over the last two years, I have been clear about my unwillingness to raise taxes, including property taxes. I appreciate the work done by the Legislature to reduce the amount needed to close the Education Fund deficit through a combination of one-time money and changes to property tax adjustments that reduced the tax increase to $33 million. But again, I will not sign a bill that raises property taxes.

H.911, as passed, achieves $13 million dollars in avoided tax increases in two ways:

- First, it reduces the house site value eligible for a downward property tax adjustment from $500,000 to $400,000, consistent with my proposal, saving approximately $2 million in each of the next five years for a projected five-year savings of almost $10 million. We have no differences on that provision in H.911; and
- Second, the bill as adopted by the conferees achieves $11 million in savings through changes to income sensitivity in FY19 by lowering the eligible house site value from $250,000 to $200,000 for households who earn over $90,000.

I am very concerned about the abrupt and immediate impact the $250,000 to $200,000 change will have on some Vermonters. This change may impact as many as 21,000 households immediately, the vast majority of whom have already filed for an adjustment with the Department of Taxes. This seems unreasonable.

If the Legislature insists on this change, I propose that it be deferred until next fiscal year. With at least $160 million in additional revenue, we can work together to find the $11 million to offset the Legislature's proposal in FY19 – allowing us to communicate the change and taxpayers to plan.

My proposal also includes a "go forward" change to the income sensitivity program that will not affect any current Vermont homeowners, and will better focus the program on those living in homes valued near the Vermont average. This is a similar approach that is used in many pension reforms, which limits the impacts to new employees after a date certain. Vermonters establishing a new homestead after July 1, 2018 would receive property tax adjustments where the maximum house site value used in the computation will be $250,000 minus household income. This system will moderate some of the adjustments going to higher income recipients and those living in homes valued well in excess of the statewide average. There will also be an enhanced benefit for many new homeowners: by allowing a deduction of the claimants' exemptions in computing household income, many families will enjoy a greater benefit than the current system.

Finally, the Legislature did not include my proposal to reduce the excess spending threshold gradually over five years beginning in FY20. This step is a cost containment provision that, when implemented gradually over time, will result in concrete savings, over the course of the five-year plan. Understanding the Legislature's hesitancy to discuss staff-to-student ratios, this is an additional tool that will potentially help avoid the need to set ratios in statute and give districts the guardrails they need to navigate the additional work necessary to achieve the goals of Act 46.

In summary, while there is a fair amount of detail here, the changes needed in the Special Session to the property tax provisions are limited and straightforward:

- The property tax adjustment change of eligible house site value from $250,000 to $200,000 in Section 14 should be deferred to an effective date of July 1, 2020;
- Reform the property tax adjustment calculation for new homesteads after July 1, 2018; and
- The excess spending threshold could be reduced over time.

This latter action will achieve savings beginning in FY20 that will increase from $3 million to $10 million in 2024.

I realize there are alternative proposals supported by legislators that could achieve the same result. I am willing to consider all alternative paths forward if they achieve level property tax rates and contribute to long term cost containment.

<u>Transition to Statewide Health Care Bargaining</u>

Creation of the staff-to-student ratio task force in H.911, coupled with the passage of H.897 which restructures the delivery of special education services, are key non-tax policy components of a multi-year plan. The final component is to move to a statewide health care benefit for school employees – one that, if achieved last year, would have saved districts up to $26 million in health care costs while bringing certainty and parity to teacher and staff plans.

I believe we all now agree this change is necessary, especially considering the wide disparities and increased costs that resulted from the last round of bargaining at the local level.

I applaud the Vermont-NEA for stepping forward and recognizing the need for this change and the work late in the session devoted to design and implementation of a statewide negotiated benefit. As I have advocated since the start of the session that this important step should be taken by placing the benefit in to law for two years providing time for a viable plan supported by all the stakeholders to be achieved. This language is present in H.858, which could be put in session law in the budget during the Special Session.

Staff-to-Student Ratio Task Force

As mentioned above, I am very pleased that the Legislature created a staff-to-student ratio task force in H.911. Since legislators immediately expressed skepticism with implementing a mandated ratio target, I proposed achieving an established staff-to-student ratio over time through sound management of the naturally occurring vacancies, many expected through the final stages of implementation of Act 46, with the help of a task force to develop recommended strategies for schools. It is crucial that this task force also take into account that there is no "one size fits all" approach because of our different school sizes and configurations. The Task Force will provide critical input on how best achieve optimal target ratios and will inform the work of school districts as they prepare their FY20 budgets and the work of the Legislature next session.

H.924 An Act Relating to Making Appropriations for the Support of Government

In general, I'm pleased to see the Legislature included most of the priorities outlined in my budget proposal in January. While I would have preferred a slightly lower level of spending growth – H.924 grows the General Fund by almost $6 million more than the budget I submitted – and I would have made different choices on a few specific appropriations as outlined in the Administration's May 8, 2018 letter to the budget conferees, I commend the House and Senate on the body of work they have done.

As was the case last year, however, the budget and yield bill are intrinsically linked. The appropriations made from the budget to the Education Fund are contingent on the tax rates set by the statewide yields. While I do not expect the level of the appropriation to change this year, we can reduce our current dependence on property taxes to fund them. This will require some combination of different decisions on General Fund surplus money and tobacco settlement money than those made in H.924.

Specifically, the $34.5 million in appropriations to Vermont State Teachers Retirement System from both tobacco settlement money and surplus General Fund money should be redirected to the Education Fund. While making an extra payment on the unfunded liability this year will yield long-term savings in avoided interest, Vermonters won't see this savings until 2038 when the final payment is made under the current plan to pay down the debt.

In addition to reversing the transfer of the surplus to retirement, an additional $9.2 million in surplus revenue is available so that the property tax adjustment made in H.911 can be deferred to give taxpayers time to plan for it in FY20. The $7.1 million contingency in FY18, appropriated in the event Medicaid revenues fall short, could be redeployed considering the $10 million of additional drug rebates and the $7 million underspending in claims with less than six weeks to go in the fiscal year. Finally, there is an additional $2.1 million set aside as part of a $3 million contingency should sales tax revenue to the Education Fund fall short in FY18.

To achieve your goals for the Teachers' Retirement Fund, in addition to amending H.924 to reflect the above transfers, the bill could be further amended to provide the surplus be returned to the General Fund as savings accrue and then transferred to the Retirement Fund. This would meet the Legislature's goal of paying down the unfunded liability in the Teachers' Retirement Fund faster than currently laid out in the Treasurer's amortization schedule and save interest costs in the long run.

Proposal to Amend H. 911 and H. 924 As-Passed

To summarize, a consensus path forward I see at this time is the following:

Amend H. 911 as follows:

- Defer the effective date of the $250,000 to $200,000 house site value change to FY20;
- Include a reduction of the excess spending threshold over five years; and
- Reform the property tax adjustments for new homesteads after July 1, 2018.

Amend H. 924 as follows:

- Reverse the transfer of $34.5 million in surplus funds to the Teachers' Retirement Fund;
- Transfer $43.7 million in surplus funds to the Education Fund in FY19;
- Provide for reimbursement of the surplus funds to the General Fund from the savings achieved through the policy and tax changes reflected in the tax stabilization plan I proposed;
- Transfer those savings to the Teachers' Retirement Fund at the time of reimbursement; and
- Define a health care benefit in the budget in session law allowing time for the Legislature to complete its work to design and implement a structure for a statewide bargained benefit.

My commitment to reaching an agreement that stabilizes tax rates and improves the operational efficiency of our education system, so we can direct more spending directly toward the education of our kids, is unwavering. Growing operational inefficiency is eroding quality and expanding inequality between our schools – even while taxes and spending have increased to record highs and student enrollment has declined by an average of 3 students per day for 20-years and counting.

Thank you for considering my thoughts on how to proceed and my proposal for a consensus plan that will strengthen our education system without raising property taxes in a year of unprecedented surplus revenue.

Sincerely,

Philip B. Scott
Governor

PBS/kp

c: Senator Joe Benning
Senator Brian Collamore
Representative Don Turner
Representative Patti McCoy
Representative Jill Krowinski
Representative Robin Chesnut-Tangerman
Representative Barbara Murphy