PHILIP B. SCOTT
Governor

State of Vermont
OFFICE OF THE GOVERNOR

MESSAGE FROM THE GOVERNOR

A message was received from His Excellency, the Governor, by Ms. Brittney L. Wilson, Secretary of Civil and Military Affairs, as follows:

Madam Speaker:

I am directed by the Governor to inform the House of Representatives that on the sixth day of June, 2017, he returned without signature and *vetoed* a bill originating in the House of the following title:

H.509 An act relating to calculating statewide education tax rates

House Message #15
06/06/17

PHILIP B. SCOTT
Governor

State of Vermont
OFFICE OF THE GOVERNOR

June 6, 2017

The Honorable William M. MaGill
Clerk of the Vermont House of Representatives
State House
Montpelier, VT 05633

Dear Mr. MaGill:

Pursuant to Chapter II, Section 11 of the Vermont Constitution, I am returning H.509, *An Act Relating to Calculating Statewide Education Tax Rates* without my signature because of my objections described herein.

Please note, the following also addresses objections to H.518, *An Act Relating to Making Appropriations for the Support of Government*, as the two bills are inextricably linked and their relationship factors heavily into my decision to return both bills. H.518 will be returned to you in a separate message containing the same objections.

At the beginning of the session, I challenged the Legislature to give residents and businesses a break from new or higher taxes and fees in all bills passed this year. I also urged the Legislature to join me in the work of making Vermont more affordable in every way we can. H.509 and H.518 fail to achieve these goals and, as a result, I cannot support them as written. We must not be afraid to think, and legislate, differently in order to reverse our challenging demographic trends, grow the economy, and make Vermont more affordable. I have made a number of proposals to generate savings in the Education Fund, beginning with my first budget presentation. To date, the Legislature has rejected all such proposals and instead has passed H.509, which, together with and intrinsically linked to H.518, only worsens the unsustainable trajectory towards higher property taxes to support an education system with declining enrollment and extremely high per pupil costs. Instead, we have an opportunity to moderate those rates by rebasing school budgets through the transition to new plans in the Vermont Education Health Initiative (VEHI); and without asking school employees to pay more for healthcare.

Although H.509 appears to provide property tax relief for residential tax payers, it does so through an unequal allocation of the tax burden to other Vermont property taxpayers and the unsustainable, irresponsible allocation of one-time revenue sources. More specifically, H.509 increases the nonresidential property tax rate from $1.535 per $100 of assessed value, to $1.555. Property taxes are not only an impediment to living in Vermont, but also a barrier to creating jobs in our state. Most of the "nonresidential" tax actually falls on Vermonters, like employers, renters and camp owners. In fact, the Department of Taxes reports that about 60 percent of the

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property that is classified as "non-residential" has a Vermont owner. Small and medium sized businesses are the backbone of our economy, and we must make Vermont a more affordable and attractive place to do business to increase opportunities for all Vermonters. I remain determined to achieving level property tax rates for all payer groups.

Also concerning is that buying down the average residential rate from $1.527 to $1.505 in H.509 is achieved in H.518 through two sources of one-time money. First, H.509 reduced the Education Fund's stabilization reserves by $9.2 million to the Fund's statutory minimum. Second, $26.1 million in the unallocated and unreserved balance in the Education Fund was applied as it has been over the past few years.

Although the unallocated/unreserved balance in the Education Fund has been used in previous sessions to buy down tax rates, it has been done so under the assumption that the balance will not be guaranteed year after year. According to the Agency of Education, the majority of this surplus was generated as the result of the consolidation of special education administration to the supervisory district level, from the local level, in 2010 through Act 153. Overbudgeting for this expense created a surplus in the Education Fund over the past several years. However, in H.518, the anticipated special education expenditures were budgeted to more accurately reflect actual costs and it is unlikely the surplus, if any, will be realized to the extent it has in the past, for use in future fiscal years. Achieving savings through the transition to the new VEHI health insurance benefits is critically important to filling the gap that will inevitably occur in Fiscal Year 2019 when this surplus is no longer generated.

This anticipated shortfall coupled with the decision to use $9.2 million of one-time money from the Education Fund stabilization reserves creates a steep cliff for taxpayers to make up in Fiscal Year 2019. These decisions, without a sustainable plan in place to fill the shortfall, expose taxpayers unnecessarily to the risk of an increase in property tax rates, could be of concern to the rating agencies, and are difficult to understand in a political climate where federal funding for school districts could be drastically reduced. This issue alone is sufficient to justify a veto. The use of the stabilization reserve coupled with the continued reliance on one-time funds predicated on prior year reversions that may not materialize in future fiscal years ensures the likelihood of future property tax increases. I cannot support a budget that makes expenditure choices that knowingly result in higher property tax rates in future years.

Moreover, the Legislature in H.509, Section 3, passed an additional one percent transfer of sales and use tax to the Education Fund which creates a General Fund shortfall in Fiscal Year 2019 and beyond. In H.518, Section D.101.1(a), the Legislature budgets a one-time Fiscal Year 2018 fund transfer of $3.3 million. Year after year the Legislature must reconcile a growing gap between what we want to provide Vermonters and what we can afford based on our incoming revenues. Taking steps today that do not account for known future shortfalls puts the Legislature on a trajectory to increase the tax and fee burden on Vermonters. We should be taking steps to curb education spending instead of continuing to increase non-property tax sources in the Education Fund, which in Fiscal Year 2018 total $525.1 million.

Section 5 of H.509 creates a Health Benefits Commission that I believe is set up to ensure impasse. Vermont's school boards have clearly articulated over the past several months their need for a simplified process for negotiating the increasingly complex health insurance system.

Additionally, thus far the VT-NEA has shown great resistance to any change in the bargaining dynamic and to sending savings back to taxpayers. I agree it would be advantageous for these groups to be able to work through this issue without legislative interference. However, by including five representatives from labor organizations and five representatives from school boards and superintendents' organizations, it is unlikely that these conversations will be fruitful. Additionally, the State will likely have a hand in administering a statewide health benefit if legislation is introduced, and has no representation on the Commission.

While I appreciate the Legislature's willingness in H.509 to revisit this issue in the future, such as receiving findings from the Health Benefits Commission this November, and reopening contracts in September 2019, Vermont faces an immediate and growing crisis of affordability, and recapturing the available savings – without asking school employees to pay more or cutting programs for kids – can only happen during the unique set of circumstances at this moment. The reopening of contracts in September 2019 will not allow the Legislature to revisit this issue comprehensively, as contracts that settle prior to July 1, 2017 will be exempt. As we have seen from settlements to date, there is a wide range of healthcare coverage, and contracts range in length from 1 to 3 years. Therefore, this is setting up an unfair scenario for those negotiating parties that are currently at impasse, and an incentive for those who are still at the table to settle quickly. Without more explicit expectations set by the State, many agreements will likely include premium cost-sharing and out of pocket costs that eat away the available savings and, therefore, our ability to lower property tax rates.

It is essential to remember the alternatives which I have proposed, and which could have been taken up by the Legislature, to put Vermont on a new and more sustainable economic footing. Beginning with my recommended budget in January, I encouraged legislators to look for savings in the Education Fund, specifically in health care costs for school employees, to keep property tax rates for all payer groups level. During the 2015-2016 Biennium, in the context of Act 46, we heard it was nearly impossible to control education spending, despite declining student enrollments, due to the uncontrollable rising cost of health care for educators. This resulted in legislative action to remove allowable spending growth thresholds originally applied in Act 46. Acknowledging healthcare costs are a driver in education spending, in my proposed budget I included an 80/20 premium split to achieve savings in school employees' healthcare costs and introduce equity among public sector employees. This is not only the same premium split that our State employees and eligible retired teachers pay, but would bring parity across the system for all active educators and other school employees.

My original mechanisms, level funding school budgets coupled with the premium split, to achieve savings in the Education Fund and level property tax rates, were met with much resistance, as well as opposition from stakeholder groups including the Vermont School Boards Association (VSBA) and the Vermont Superintendents Association (VSA). At the same time, my Administration began to learn more about a unique opportunity to save money in the Education

Fund through changes in the VEHI healthcare plans. It is important to note that VEHI is an intermunicipal trust made up of State municipalities, including school districts, and administers a standard offering of healthcare benefits to over 90 percent of Vermont schools. Vermont school employees constitute a single statewide risk pool insured through the VEHI offerings. VEHI healthcare plans offered to school employees for Fiscal Year 2018 have been restructured to cost substantially less than the old plans to avoid the Affordable Care Act's "Cadillac Tax." Discussions in the State House outlining plan changes, and the opportunity for savings, began in the 2015-2016 Biennium with representatives from VEHI testifying in the Senate Finance and House Education Committees.

After the introduction of my recommended budget, legislators began asking my Administration for an alternative, and I began pointing to the opportunity for savings from these VEHI plan changes. Unfortunately, it became clear that neither the House nor Senate Appropriations Committees were planning to take advantage of this once-in-a-lifetime opportunity to rebase school budgets and save Vermonters millions on an ongoing basis. Therefore, to propel this conversation forward, I introduced a policy proposal – through collaboration with the VSBA and the VSA – that ensures there is a mechanism to recapture up to $75 million in available savings. In my proposal, I recommend reinvesting nearly $50 million back into school employees to make sure they don't pay more for out of pocket expenses, and returning the remaining $26 million to all classes of property taxpayers to keep all property tax rates the same as Fiscal Year 2017. I also suggested investing in other education priority areas, such as early care and learning, higher education, and shoring up the Vermont State Teachers Retirement Health Insurance Program.

My proposal calls for the State to negotiate with the school employees' unions for the VEHI health benefit. Other states, like Massachusetts which has an opt-in state health plan, have started moving in this direction. My proposal does three things: First, it maintains the right of school employees to bargain this valuable benefit through a joint body representing all school employees with a single voice and an opportunity to maximize benefits for all school employees equally. Second, my proposal assumes sharing the cost savings with school employees through the creation of a health savings or health retirement accounts (HSA or HRA) funded with a majority of the VEHI plan savings. Third, it creates a mechanism for recapturing the VEHI cost savings built into the existing school budgets and returning those savings to Vermont property taxpayers. This makes particular sense because school employees participate in a statewide insurance risk pool now.

While my goal is not a statewide teachers' contract, elevating benefits to the State level has been floated numerous times in the Legislature, as recently as 2014, when it was included in a December 12, 2014, report from then-Speaker Shap Smith's Education Finance Working Group, which included current Speaker Mitzi Johnson and House Education Chair David Sharpe (see pg. 3, number 8: "*Have the Agency produce a model teachers' contract that districts could use during labor negotiations. Explore the idea that districts could opt-in to a statewide contract*").

Under my proposal, local school boards would still bargain with school employees over all other compensation and benefits. Healthcare benefits would be bargained one time, instead of more than 60 times, which would give the maximum potential to realize up to $75 million in savings (noting that contracts which have been ratified to date will not be reopened).

Despite our differences, I remain fully committed to working with the Legislature on a solution in H.509 and H.518 that meets the following core principles:

1. *Maximize Savings* – Any alternative must maximize the savings opportunity of the transition to these new healthcare plans;

2. *Keep Teachers Whole & Provide Parity* – Any alternative must hold educators harmless and provide parity and uniformity across the system; and

3. *Simplify Negotiations for School Boards* – Any alternative must reduce the burden currently on school boards negotiating these new, more complex insurance plans.

I am encouraged there is agreement between the Administration and the Legislature that the transition to the new VEHI plans provides an opportunity to save millions of dollars. While I first and foremost prefer a negotiated statewide health benefit, I am willing to consider negotiations remaining at the local level. However, it will require a policy mechanism in H.509 that mandates the parameters of the benefit plan, or provides a strong and equitable financial incentive for both school boards and unions to reach settlements that are within the constructs of the Gold CDHP VEHI model. That model includes an 80/20 premium split with at least the first $400 out of pocket cost borne by the employee through an HSA or HRA.

As noted earlier, I am also willing to return 100 percent of savings to all classes of property taxpayers to further bring down property tax rates, which is a primary advantage of seizing this opportunity, rather than reinvesting equal portions into early childhood and higher education and shoring up the Vermont State Teachers Retirement Health Insurance Program, in addition to tax relief, as was originally proposed. It is worth noting that at adjournment on May 18, 2017, an agreement with House and Senate leadership was within reach.

Again, H.509 and H.518 are fundamentally tied. The appropriations made from the Education Fund in H.518 are contingent upon the revenue provided by H.509. If the funding raised through H.509 changes, the allocation of funding in H.518 needs to be updated to reflect a change in the amount of available funds. For reference, the specific line item in H.518 is B.505, Education – adjusted education payment. It would also eliminate the need for the transfer from the Education Fund's stabilization reserves, as discussed above.

Given the opportunity I have outlined to save taxpayers millions of dollars through the new VEHI healthcare plans, the education payments in the budget should be adjusted by the amount of savings expected from transitioning to the new VEHI healthcare plans.

I promised Vermonters I would listen to any idea to make Vermont more affordable, and that is what I'm doing. We have been losing, on average, six workers from our workforce, and three students from our schools every day. We literally cannot pass up this opportunity to put a dent in property tax growth. My education savings proposal allows us to bring down property tax rates while not requiring education employees to pay more or cuts to programs for kids.

Under my proposal teachers will not be exposed to higher out of pocket costs and will still enjoy robust healthcare plans with higher than average actuarial values. Neither H.509 nor H.518, as presented for my approval, takes any steps to provide a mechanism to recapture the available savings for the Fiscal Year 2018 budget, which could be as much as $13 million, or alleviate the property tax burden on all rate payer groups.

As noted, based on the outstanding objections outlined above I cannot support H.509 or H.518 and must return both bills without my signature pursuant to Chapter II, §11 of the Vermont Constitution. If the veto is sustained, I know we can come to an agreement, and when we do, H.509, H.518, and Vermonters will be better for it.

Sincerely,

Philip B. Scott
Governor

PBS/kp