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Susanne R. Young, Secretary

TO: **Representative Janet Ancel**

CC: **Senator Ann Cummings, Chair, Senate Finance Committee**
Rebecca Holcombe, Secretary, Agency of Education
Adam Greshin, Commissioner, Department of Finance and Management
Kaj Samsom, Commissioner, Department of Taxes

FROM: **Secretary Susanne R. Young** SY

SUBJECT: **Continuing the collaborative discussion on reforming education funding, alleviating the property tax burden and closing the gap between revenues and spending**

DATE: **January 18, 2018**

Thank you for your continued willingness to an open, honest discussion on the challenge in the Education Fund.

The Administration's goal is to work with you to eliminate the current deficit, establish a more affordable and sustainable way to fund our schools into the future and provide districts the necessary flexibility to save money while maintaining quality and expanding opportunities for our children.

We appreciate your committee's willingness to take on this difficult conversation, and to do so with an open-mind and a sense of urgency. We want you to know that we are committed to giving all of your ideas fair consideration as well. As the Governor has repeatedly noted, solving this complex challenge requires that we put all ideas on the table. In this spirit, we offer additional ideas for further study and consideration.

It is our view that Vermonters want us to work together and be willing to think outside the box that has constrained education financing discussions for many years. And we know they want us stave off the continued growth in statewide property tax rates, which has been increasing faster than wages – even for Vermonters who are income sensitized.

Alongside ideas for immediate tax relief, we believe we must also collaborate on a multiyear plan to transform school systems and leverage economies of scale that will release resources that can be used to alleviate tax increases and invest in more and better opportunities for our kids. It will be a challenge to balance urgent needs with a longer-term plan, but both must be a focus throughout.

The Administration looks forward to discussing the ideas in the enclosed memo as well as any other offered in the coming weeks to reach a favorable outcome for Vermonters. If there are any ideas in this memo you would like to pursue further, we would look forward to working with you.

Some Background on the Administration's Perspective:

Under the current funding formula, the local homestead property tax rates are believed to be the primary regulator on local education budgets. To the contrary, it is our view that all evidence suggests the current formula does not adequately connect local budgets to local taxpayers in a way that would constrain statewide property tax growth to a rate that is less than the growth in wages. Put another way, the current system allows tax rates to rise faster than the taxpayers' ability to pay, without falling economically behind.

Specifically, looking at budgets and homestead property taxes in the aggregate, the Vermonters voting on a local budget (as well as the majority who do not vote on school budgets) contribute, on average, 27 cents on the dollar ($458 million/$1,681 million).

Many of the changes to the funding formula outlined below seek to further localize the tax implications of budgets after a level of state support that, according to our counsel, meet the Brigham test. In other words, these ideas reflect attempts to establish a stronger connection between local spending decisions and local taxes.

Additionally, while we view reforming the funding formula as one area of opportunity, we propose ideas to close the gap between revenues and budgets. It is our view that Vermonters deserve a second consecutive year of level, or slightly lower, statewide property tax rates. We understand that this is a challenge, particularly given the nature of our two-decade old funding formula and the population trends that are impacting both the tax base and the total number of students we serve.

As we note above, we look forward to discussing these ideas with you and look forward to hearing your proposals as well.

Cost Containment (Dept. of Finance and Management)

$1.5 million – Freeze special education rates for independent schools at 10/1/17 rates: Although this does not require legislative approval, the legislature could include it in the cost containment conversation. The state contribution to special education services in public schools has been level funded the last three years, due in large part to districts over-budgeting for this expense.

$1.5 million – Increase IEP extraordinary reimbursement threshold from $50k to $77k and tie future increases to inflation: This threshold has not been increased for two decades. Currently, the cost to support kids on IEPs is shared between the supervisory union or supervisory district and the state, with the state contributing 60 percent up to $50k and 90 percent when that threshold is exceeded.

$3 million – Establish in statute the recommended cost sharing arrangements (in Act 85) for employees' health benefits for contracts ending before 7/1/18: Based on the settlement data reported to the VEHBC, we know most districts missed the targets outlined in Act 85 by a considerable margin. Premiums are increasing because a large majority of contracts negotiated at the local level agreed to use Health Reimbursement Accounts that do not roll over into later years to compensate employees for their higher out-of-pocket exposure. This outcome alone contributed to a more than a one-cent increase on property tax rates – about half of the 16.8% rate increase requested by VEHI in late September 2017.

$30 million – Achieve a student-to-staff ratio of 1-to-4.45 through attrition in FY19: Over the last five years, teacher retirements alone have averaged 470 (which does not include paraprofessional and other school staff). Current student-to-staff ratios are 1-to-4.25. By increasing by two tenths in year one, significant savings could be achieved. The improvement could be managed by attrition through retirements, vacancies and management of positions across governance structures. How to achieve these higher ratios should be left to the highest governance level in a supervisory union or district to provide flexibility, while meeting the unique needs in different SUs/SDs. The five-year initiative could be to achieve student-to-staff ratios of more than 1-to-5 in the aggregate, saving approximately $100 million/year once implemented.

Total = $36 million

Reforming Education Funding: (Dept. of Taxes)

$20 million – Set yields and non-residential rate at a level to raise up to $17,000 per equalized pupil. This amount would constitute the state's contribution to local districts' budgets. Districts who spend more than $17,000 per equalized pupil would be required to raise the difference on their local homestead grand list. A payment of $17,000 per equalized pupil is an increase to the statewide average but would ultimately be a reduction of $20 million in total education spending, providing relief to statewide property tax rates.

$26 million – Cap statewide property tax rates at 2.5% per equalized pupil: Cap the revenues raised through the current statewide funding formula to 2.5 percent of FY18 per pupil expenditures. All per pupil education spending more than 2.5 percent of FY18 per pupil expenditures would have to be raised on the local homestead grand list. To local districts, this will be a small adjustment to the local homestead grand list.

Education spending as of 12/1/17 is expected to increase by 3.9 percent per pupil across the state. Although some districts may come in lower than this projection, many districts' budgets will exceed 2.5 percent per pupil growth. Those districts will not know with any certainty the local tax impact of their budget, unless the legislature makes changes before budgets are warned in late January and early February or enables additional budget votes after adjournment.

$37 million – Implement a variable growth cap on per equalized pupil spending: The table below shows allowable growth caps across varying spending brackets to achieve these savings. The total modeled savings under the parameters outlined in the table is $37 million on the statewide property tax base. Per pupil spending exceeding the allowable growth targets is shifted to local homestead grand lists.

FY18 Per Pupil Spending		FY19 Allowable	
Between	And	Growth	Districts in Bracket
$ 10,000	$ 11,000	4.0%	2
$ 11,000	$ 12,000	3.5%	3
$ 12,000	$ 13,000	3.0%	13
$ 13,000	$ 14,000	2.5%	22
$ 14,000	$ 15,000	2.0%	28
$ 15,000	$ 16,000	1.5%	43
$ 16,000	$ 17,000	1.0%	30
$ 17,000	$ 18,000	0.5%	24
$ 18,000	and up	0.0%	9

$3.4 million – Freeze the total income sensitivity adjustment at FY18 level: The FY18 income sensitivity adjustment payments totaled $173 million. If that adjustment were frozen for FY19 the education fund would pay out $3.4 million less than forecasted and provide time to further consider this issue in the context of a 5-year plan.

\$5 – \$7 million – Apply an asset test and change the income sensitivity calculation: Under current law, passive income over \$10,000 is double counted toward household income for all filers under age 65. To earn more than \$10,000 in passive income an individual or married couple would likely have a better ability to contribute than required under current law. When coupled with a change to the qualifying house site value in the current income sensitivity calculation, up to \$7 million in additional savings, spread over a wide group of property tax payers, could be achieved.

\$1.5 million – Change Current Use Program to reflect land values across Vermont towns (\$1.2 million Education Fund; \$0.3 million General Fund):

Participants in the Current Use Program pay taxes on the "use value" of their enrolled land and farm buildings. The use values are set by the Current Use Advisory Board and applied statewide. The tax differential paid into the Education Fund on these enrolled properties is \$45 million. Additionally, the General Fund reimbursement for municipal taxes on these enrolled properties is approximately \$16 million.

If an 85 percent exemption for all enrolled properties were applied, in lieu of the set value construct, approximately \$1.2 million in savings to the Education Fund and \$0.3 million to the General Fund would be achieved. Geographic equity would also result because the existing structure of Current Use provides a larger benefit to participants in towns with higher property values. The percentage method would provide a uniform conservation/development balance across all towns.

\$6 million – Refill the education fund reserves to 5 percent by FY2021: The statutory minimum for the education fund reserves is 3.5 percent and the current fund reserve is at 3.6 percent. It is important to refill the reserves to statutory maximum of 5 percent, which if done in FY19, will cost \$8.9 million. If filled incrementally, by approximately \$3 million over each of the next three years, the reserves will be at the statutory maximum by FY21.

\$1 million – Remove all exemptions from the excess spending threshold: There are currently fourteen exemptions to the excess spending threshold including the exemption for districts that tuition all their students. These exemptions insulate local tax payers from the full impact of local budget decisions. Removing the exemption may encourage those districts to evaluate their long-term options or work more collaboratively on cost containment with the receiving districts in their area.

\$3.2 million – Reduce excess spending threshold from 121% to 115%: Currently, budgets exceeding the statewide average per pupil spending from the prior year are subject to an excess spending assessment. Reducing the threshold from 121% to 115% increases the number of districts subject to the assessment. The \$3.2 million projection takes into effect behavior at the local level to come in under the threshold as well as increased penalty payments by high spending districts.

Total = \$39 – 58 Million

Five-Year Initiatives: (Agency of Education)

Create a school consolidation commission: Create a commission to consider whether all schools with extremely low student populations and student-to-teacher ratios remain viable. If deemed non-viable, the commission will consider the most cost-effective way to consolidate schools in the same, or adjacent, district.

The commission will also review vacancy rates of schools in newly merged districts and make recommendations directly to districts and to the State Board of Education on ways to better utilize space in schools. Part of this review should consider potential savings from closing schools in SUs/SDs with excess capacity.

Collaborate with SUs/SDs to develop five-year attrition plans: The Agency of Education could assist in developing a framework for supervisory unions and districts to create these plans if necessary. The Administration and Legislature should allow SUs/SDs to reinvest a portion of savings into programs or other needs.

Consider the regulatory environment and determine whether it is contributing to high student-to-staff ratios: Feedback from the Governor's education summit suggested a lack of flexibility in staff and teacher requirements contribute to the number of adults in buildings. Two options could be explored: first, ask the VSBPE (Vermont Standards Board or Professional Educators) to ensure an elementary endorsed teacher be allowed to seek an extension of grade levels when employed by a K-8 or other such school. Second, initiate a review of the current list of endorsements, with the goal of reducing the number of endorsements and/or creating more general endorsements.

Adopt recommendations from the UVM study on Vermont's funding of special education: University of Vermont's College of Education and Social Services recently released a report examining Vermont's state funding of special education. As previously highlighted, the study finds Vermont spends between 150 and 200 percent more per student on an IEP than other states with no discernable differences in outcomes. The report recommends the state reconsider the way it funds special education services, moving toward census block grant model over five years. The Administration supports this recommendation and would like to work with the legislature and education stakeholders to implement this plan. The report identifies the potential for $75 million in savings through successful implementation.

Enact a two-vote structure for districts with student-to-staff ratios below 1-to-5: This approach would require districts below the target ratio to vote twice, the first time on a budget that supports the target student-to-staff ratios and a second time on the actual budget supporting the lower ratio. This would provide greater local transparency and accountability.

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