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

Agency of Administration

December 1, 2016

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) 2018 so that the required analysis could be performed. Many thanks go to these departments for their hard work.

Current Forecast of Education Tax Components

Act 46 of 2015 changed the structure of this letter. This is the second year of the new structure. Act 46 set the homestead property rate in statute at $1.00 per $100 of equalized education property value. 32 V.S.A. § 5402(a)(2). Similarly, the rate for those paying on income is set at 2%. 32 V.S.A. § 6066(a)(2). Therefore, the important numbers communicated by this letter are the property dollar equivalent yield, the income dollar equivalent yield, and a nonresidential rate.

At this time, the yield amounts and the nonresidential rate forecasted in this letter, in addition to the other Education Fund revenue sources, are anticipated to generate enough tax revenue to pay for state education spending and to maintain the statutory reserves at 5.00%.

The process of determining the two yields and the nonresidential rate begins by estimating education expenses in the following fiscal year, the bulk of which is locally-voted education spending in the districts. Agency of Education staff estimate anticipated spending figures from districts around the state. The projected education expenses for FY18 are $1,617M, an increase of 2.54% from last year. Overall growth would be lower if districts vote to hold down their local education spending.

Education Expenses (millions)

	FY15 (Final)	FY16 (Final)	FY17 (Preliminary)	FY18 (Projection)
	$1,514	$1,553	$1,577	$1,617
Year over Year Change	4.25%	2.56%	1.53%	2.54%

Source: Agency of Education, JFO

The actual number of students in Vermont continues to decline despite the expansion of pre-kindergarten programs. Beyond population changes, the number of equalized pupils (a calculated figure used in the determination of district rates) shows additional declines due to the phaseout of a "hold-harmless" provision for districts with declining enrollment. Between July 1, 2016 and July 1, 2020, the calculation for equalized pupils is based increasingly upon a district's actual, not inflated, pupil count. Sec. 22 of Act 46 of 2015.

Another important component for setting the yields and the nonresidential rate is the projected size of the education grand list. Grand list growth comes from new construction and appreciation in property value. Appreciation (or depreciation) is captured when towns reappraise and by the Tax Department's equalization study in intervening years. The percentage increase in the equalized grand list for FY2018 is projected to be about the same as it was for FY2017.

Equalized Education Grand List (millions)

	FY15 (Final)	FY16 (Final)	FY17 (Preliminary)	FY18 (Projection)
	$78,133	$78,786	$79,918	$81,067
Year over Year Change	-0.43%	0.84%	1.44%	1.44%

Source: Department of Taxes, PVR Annual Report

The last important component in the education tax rate setting process is income growth. About two-thirds of Vermont resident households (homesteads) pay their property taxes based on their total household income from the previous calendar year. Household income refers to the household income calculated under 32 V.S.A. § 6061. The chart reflects the median household income for households with under $90,000 of household income as those are the households paying entirely on income.

Median Household Income (for households under $90,000)

Calendar Year	2013	2014	2015	2016 (projected)
	$44,766	$45,430	$47,938	$49,437
Year over Year Change	1.45%	1.48%	5.52%	3.13%

Source: JFO; Tax and State Economists

Grand list growth and income growth mean that the base homestead property rate of $1.00 and homestead base income rate of 2.0% will both "yield" more revenue. The practical effect of the property yield and income yield going up is decreased pressure on the rates Vermonters pay to fund education for the same level of per pupil spending.

5402b(a)(2) Mandated Forecast

As defined in statute, the homestead education property tax rate for FY2018, 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 nonresidential 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 yields. 32 V.S.A. §5402(b).

With all contributing factors as they appear on December 1, 2016, the FY2018 property yield, income yield, and nonresidential rate are forecasted as followed:

Base Rates and Yields[1]	FY2017 (for comparison)	FY2018
Homestead Property	$9,701	**$10,076**
Income	$10,870	**$11,875**
Non-Residential Property	$1.535	**$1.550**

If the yields calculated in this letter were ultimately adopted, a district spending $15,000 per pupil in FY18 will see a homestead rate of $1.49 per $100 of property value ($15,000 spending / $10,076 homestead yield). The same district will see an income rate of 2.53% (2% x $15,000 spending / $11,875 income yield). The resulting homestead and income rates for a district at this per-pupil spending level are lower than they would have been last year, when the yields were lower.

[1] This forecast relies on devoting all of the reverted funds from prior years to increase the yields for everyone.

Despite the increase in the yields from last year, the median tax bill for all three types of payers is projected to increase 2.35% over last year based on the expected increase in locally-voted district spending and the appreciation in property value and household income.

Conclusion

This letter provides a general outline of the components that drive the statewide yield amounts and the nonresidential tax rate, and a preliminary recommendation based on the data available as of today. The most important of those components, school spending, will not be finalized until local districts vote their budgets 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 nonresidential rate should be set lower as well. The yields and corresponding nonresidential tax rate will ultimately be set by the Legislature based on updated information provided during the session.

In addition to informing the statewide yields, locally approved per pupil spending is the primary factor in determining the education tax rates in each town. This has been the case since Act 60 passed in 1997, but is especially important now considering the Act 46 merger incentives and the re-configuration of districts. For these reasons, there will be a great deal of variation in tax rates around Vermont in FY2018, and the average rates or median change cited in this letter should not be construed as typical. To help constituents and stakeholders understand how their tax rate was determined, the Tax Department has updated and significantly improved the literature and resources available on our website.

Sincerely yours,

Mary Peterson
Commissioner, Department of Taxes

cc: Trey Martin, Secretary, Agency of Administration
Rebecca Holcombe, Secretary, Agency of Education
Andy Pallito, Commissioner, Department of Finance and Management
Rep. Janet Ancel
Sen. Tim Ashe
Rep. David Sharpe
Sen. Ann Cummings
Stephen Klein, Joint Fiscal Office
Luke Martland, Legislative Council