Vermont Legislative Joint Fiscal Office

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FISCAL NOTE

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Preliminary Outlook for Education Tax Rates in FY2019

On November 30th, the Commissioner of Taxes submitted a letter to the legislature recommending a significant increase in current-law education tax rates for FY2019 in fulfillment of the statutory obligation set forth in 32 VSA §5402b. This recommendation is determined by the Commissioner after consultation with the Secretaries of Administration and Education and the Joint Fiscal Office.

	FY2018	FY2019	Increase
Average homestead property tax rate	$1.500	$1.594	$0.094
Average household income tax rate	2.55%	2.65%	0.10%
Uniform non-homestead property tax rate	$1.535	$1.629	$0.094

Note that the Commissioner's recommendation is only the starting point for deliberations during the 2018 legislative session. The Administration may propose and the Legislature may take steps to reduce some or all of the recommended increase in education tax rates in FY2019.

1. Use of Nonrecurring Revenue Sources in FY2018

a. Use of the FY17 Education Fund surplus

In FY2018, $26 million from the FY2017 surplus was returned to taxpayers in FY2018 through lower education tax rates. No surplus currently exists in FY2018 for use in FY2019, so at this time these funds must be replaced from another revenue source. All else being equal, replacing these funds will increase average education tax rates by roughly 3 cents in FY2019.

b. Use of the Education Fund stabilization reserve

In FY2018, $8 million from the stabilization reserve was used to lower education tax rates in FY2018. By statute, the Commissioner's recommendation must assume that the reserve is restored to 5% of prior-year net appropriations. Although the reserve may be reduced to 3.5% while remaining within statutory parameters, the State Treasurer has expressed concern that not fully restoring the reserve to 5% in FY2019 could jeopardize the State's bond rating. All else being equal, restoring the reserve to 5% will increase average education tax rates by almost 1 cent in FY2019.

2. Growth in the Education Payment in FY2019

The Agency of Education (AOE) estimates that the education payment will grow by 3.5% or $46 million in FY2019. Actual growth in the education payment will not be known until after school boards submit their proposed budgets to AOE in late January. All else being equal, a $46 million increase in the education payment will increase average education tax rates by roughly 5.5 cents in FY2019.

a. Nominal growth in education spending in FY2019

The cost of state and local government services is projected to grow by 2.8% in FY2019. Consequently, the FY2019 cost of providing the same educational services that school districts provided in FY2018 will be about $37.9 million higher.

b. Growth in teachers' health insurance premiums

According to the Vermont Education Health Initiative (VEHI), teachers' health insurance was underpriced in FY2018 because school districts chose, through collective bargaining, to cover a greater-than-anticipated share of teachers' out-of-pocket health care costs. VEHI plans to use over $9 million of its reserves to cover the FY2018 projected shortfall and to hold down rate increases in FY2019. Nevertheless, VEHI has requested a significant increase in rates in FY2019 ranging from 6% to 17% depending on the plan (actual rates will be determined by the Department of Financial Regulation). We will not be able to estimate the full impact of higher premiums on districts until we have contract details and enrollment data.

c. Recapture of assumed teachers' health insurance savings

Under current law, education payments will be reduced by $8.4 million in FY2018 and $4.5 million in FY2019 to recapture *assumed* teachers' health insurance savings. School districts that were unable to achieve these savings or cover the cost with local reserve funds or find savings elsewhere in their FY2018 budgets will carry a deficit that must be addressed in FY2019. We do not have detailed information on spending, but any deficits in FY2018 may show up as higher education spending in FY2019.

d. Depletion of local reserves in FY2017

Act 46 imposed per-pupil spending targets on school districts in FY2017 and FY2018. To avoid the tax penalties levied for exceeding their targets, many districts used local reserve funds to reduce per-pupil education spending. These spending targets were repealed for FY2018, but it is unlikely that districts have been able to restore their reserves for potential use in FY2019. Any reserve funds used to cover ongoing spending in FY2018 will need to be replaced from another revenue source in FY2019.

3. <u>Other Factors</u>

a. Transfer of the cost of teachers' pensions to the Education Fund in FY2018

The normal cost of teachers' pensions – nearly $8 million in FY2018 – was transferred from the General Fund (GF) to the Education Fund (EF) in FY2018. Roughly one-half of the cost of this transfer was covered with GF revenue: in FY2018, an additional $3.3 million was transferred from the GF to the EF; and beginning in FY2019, the EF allocation from the sales & use tax was increased from 35% to 36% or about $4 million. The remainder was partially offset by recognition of declining costs for correctional education. All else being equal, the net cost of these decisions will increase average education tax rates by almost 0.5 cent in FY2019.

b. Growth in special education aid in FY2019

After three years of level funding, special education aid was underfunded in FY2018. Consequently, the FY2019 appropriation for special education aid reflects two-years of growth. At over $189 million, special education aid is the largest Education Fund use after the education payment. All else being equal, an additional $8.5 million in special education aid will increase average education tax rates by almost 1 cent in FY2019.

c. Slow growth in the property tax base in FY2019

The value of the education grand list has now returned to its pre-recession level; however, growth in property values continues to be slower than anticipated. Statewide property values will increase by less than 1.4% in FY2019 - well short of the projected rate of inflation. Property values do not affect statewide education tax *revenues*, but education tax *rates* are higher than they would be with more robust growth. All owners of non-homestead property and about one-third of owners of homestead property pay the education tax entirely on the value of their property.