Report on Tax Rates for Member Towns of Unified Union Districts

Act 132, sec. 9(d) of 2016

REPORT
April 2017

Report/Recommendations to the Senate Committees on Education and on Finance, and the House Committees on Education and on Ways and Means

Submitted by Secretary of Education

Rebecca Holcombe

VERMONT
AGENCY OF EDUCATION

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Legislative Reporting Requirement

Act 132, sec. 9(d) of 2016, requires the Agency of Education to make recommendations to the General Assembly on how best to calculate tax rates for member towns of a new unified union district when the town tax rates differ from the incentive tax rate for the new unified district. This report was done in consultation with the Vermont School Boards Association, the Vermont National Education Association, and the Vermont Superintendents Association.

This report was due on or before December 15, 2016, but also had a requirement for the Agency to review preliminary budget data for all unified districts eligible for tax rate reductions in FY2018. However, budgets are usually not finalized until mid-January, meaning they are still very much in development as of December 15. This report is late so that districts could move ahead in their budget development process so that the Agency could gather more meaningful data.

Background

In 2010, Act 153 allowed for homestead tax rate reductions for the first four years of a newly formed unified union district that met specific criteria. Those criteria were expanded by Act 156 in 2012. Act 46 of 2015 further expanded those criteria and allowed for five years of tax rate reductions if certain criteria were met in a set time period.

The Legislature recognized that even with the rate reductions, some member towns would likely see a tax rate increase due to the formation of the new unified union district. As a result, the Legislature eased the transition of a town's tax rate to the new unified rate by limiting the town's annual rate increase to no more than 5% until it reaches the unified rate. The tax rate used is the equalized rate so as to avoid rate changes caused by fluctuations in the common level of appraisal (CLA).

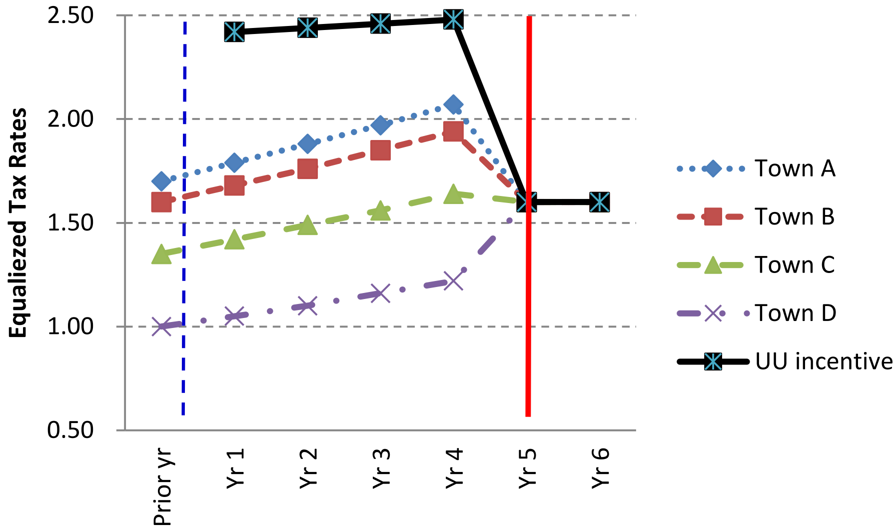
Additionally, the Legislature implemented a similar transition methodology for those towns with tax rates greater than the new unified rate. For those towns belonging to new unified districts eligible for tax rate reductions for a four year period, if the town's prior year rate was greater than the new unified rate, the town's annual rate decrease is limited to no more than 5% until it reaches the unified rate.

In both of the above scenarios, once a town reaches the new unified rate, the town's tax rate is the same as the unified rate, regardless of the annual percentage change.

The Issue

As the tax rate reduction language is currently written – i.e., a town's equalized homestead tax rate cannot increase by more than 5% annually during the incentive period – member towns are insulated from large increases in spending decisions made by the new unified district. As a hypothetical example, the voters of a new unified district could approve a budget with education spending that resulted in a 40 cent increase in the unified tax rate. But the member towns – the same set of voters approving the large increase in spending – are limited to a rate increase of no more than 5%. Assuming a town's prior year equalized homestead rate was $2.00, the town's rate increase would be limited to 10 cents versus the 40 cents the voters approved. (For perspective, only three towns have equalized homestead rates greater than $1.95 in FY2017.)

Graph 1: Hypothetical example of member town rate increases versus high level of unified district spending



A relatively low tax rate increase compared to the increase in per pupil spending (and what the rate should be) means the voters in the town will pay relatively low education property taxes, with less money going into the Education Fund. But since education funding is a statewide obligation and all towns pay into the Education Fund to support all school districts, the property and homestead yields must change in order for the Education Fund to remain whole. The other towns in the state that do not belong to the new unified district will be required to increase their education property taxes via increased education tax rates to make up for the shortfall, while at the same time, the towns in the merger will see an overall reduction in their rates, although changes in the property and income yields will also affect the new unified rate prior to incentives.

There is nothing in current language to prevent a new unified district from having a very high level of per pupil spending for all four or five years of tax rate reductions, depending on the unified scenario. As an extreme example, a unified district could increase spending to $80,000,000 annually for the years of rate reduction, with member town tax rates increasing only 5%, amassing large surpluses annually, surpluses paid for by other towns. Those surpluses could then be used to lower homestead tax rates for the unified district and member towns for a number of years into the future.

The limitation of a 5% change in a member town's tax rate should be modified so that the change is tied to any large or unusual spending decision the voters of a new unified make.

However, tax rates are also affected by equalized pupil counts. A decrease in the equalized pupil count of a district with flat spending will result in an increased homestead tax rate. A new unified district cannot necessarily cut spending proportional to a decrease in its equalized pupil count. If a unified district (which is a preK-12 district) was to lose 30 equalized pupils from one year to the next, unless those lost students were all in two or three grades, the unified district would find it difficult to adjust spending accordingly by reducing staff. Therefore, the tax rate could show a significant increase through no real fault of the district.

Act 46 also changed the hold-harmless provision for equalized pupils, which can exacerbate the above without a district really losing students. The change was designed to eliminate the artificial increase in equalized pupils some districts received for multiple years. These are the phantom pupils. The change still protects districts from a rapid decline in pupils, but for one year only and rapidly removes any accumulated phantom students a district may have in two or three years.

As noted above, this rapid loss of phantom pupils can have a significant impact on a new unified district's tax rate as the equalized pupil count rapidly declines. Additionally, tuitions paid by a unified district are largely out of its control, as are emergency expenditures for things such as a leaking roof, a new boiler, etc. While the 5% limitation on a town's tax rate increase should be modified to tie it to large increases in the unified district spending, circumstances out of the control of a member town or a unified district should be taken into account.

Current Situation

While no new unified districts have increased spending by large amounts, several unified districts and potential unified districts (i.e., prior to voter approval of the articles of agreement) did recognize that the potential existed to have a very modest tax rate increase for the member towns but along with a huge increase in spending. For FY2018, there are ten unified union districts and two modified union districts eligible for tax rate reductions. Based on preliminary budget data received by AOE, of those twelve entities that provided preliminary figures, none are showing overly large or unusual increases in spending.

However, while there appear to be no unusual increases in spending, tax rates are also affected by equalized pupil counts. As noted, a decrease in the equalized pupil count with flat spending will result in an increased homestead tax rate. That is being seen in some new unified districts where a relatively flat or modest increase in spending is being offset by a decrease in equalized pupils. This is even occurring in two new unified districts with decreased spending, with the resulting projected FY2018 education spending per equalized pupil figures increasing from those of FY2017.

Recommendation

As stated in Act 132, sec. 9(b)(3) of 2016:
"It is the intent of the General Assembly that any large or unusual spending increases by a new [unified] union school district continue to be reflected in the tax rates of the member towns."

In order to implement the intent of the General Assembly, the Agency, in consultation with the VSBA, the VTNEA, and the VSA, recommend the following changes to the law governing the maximum allowable equalized homestead annual rate change of +/- 5% for member towns with rates that were not at the new unified rate the prior year.

A. Make an allowance of 4% for annual growth in the new unified union due to inflation and consolidation expenses

Rationale – As districts come together into a new unified union district, unanticipated costs may arise due to the consolidation. Allowing a growth of 4% in education spending per equalized pupil will allow some flexibility to unanticipated costs. It will also allow for an increase due to inflation on an annual basis.

B. Provide an appeal mechanism to the Secretary of Education or a review board

Rationale – It is possible increases in education spending and increases in education spending per equalized pupil are beyond the control of the new unified school district. Rather than being penalized for circumstances beyond their control, the board of a new unified district may appeal to the Secretary or a review board to waive the recommended limitations on the +/- 5% tax rate change. Examples of increases beyond a board's control:

1. Declining enrollment – As noted earlier, oftentimes costs cannot be reduced at the same rate equalized pupils are lost. Exacerbating this is the rapid loss of phantom students in many districts, due to the change in the equalized pupil hold-harmless calculation (Act 46, secs. 22-25 of 2015).
2. Unifying employee contracts – Bringing all employees in various categories onto the same, appropriate salary schedules will likely increase overall spending.
3. Emergency repairs – Unexpected costs due to a leaky roof, a boiler repair or replacement, HVAC system failure, etc., will increase spending per pupil.
4. Increased tuition payments – If the new unified district is structured so that it does not operate all grades preK-12, it has no control over tuition costs it must pay for those students in grades that are not offered by the unified district. Additionally, new students may move into the district, increasing overall tuition costs.

C. If the Secretary or review board determines that the unified district's increased education spending per equalized pupil is not supported by good cause, then for those member towns not at the unified rate in the prior year, the tax rates will be calculated as follows.

Example 1. The member town's prior year rate is greater than the new unified rate:

1. If the member town's prior year rate is greater than the new unified rate, then the town's tax rate shall be decreased by no more than five percent minus the difference between a 4% increase in education spending per equalized pupil and the actual increase in the unified district's education spending per equalized pupil.

   Max % decrease = 5% - (Actual % change – 4%)

The new unified education spending per equalized pupil increases by 7%:

Max % decrease = 5% - (7% -4%)
Max % decrease = 5% - 3%
Max % decrease = 2%

Example 2. The member town's prior year rate is less than the new unified rate:

2. If the member town's prior year rate is less than the new unified rate, then the town's tax rate shall be increased by no more than five percent plus the difference between a 4% increase in education spending per equalized pupil and the actual increase in the unified district's education spending per equalized pupil.

   Max % increase = 5% + (Actual % change – 4%)

The new unified education spending per equalized pupil increases by 7%:

Max % increase = 5% + (7% - 4%)
Max % increase = 5% + 3%
Max % increase = 8%

D. If the Secretary or review board determines that the unified district's increased education spending per equalized pupil is supported by good cause, then for those member towns not at the unified rate in the prior year, section C above shall not apply and the member towns tax rates shall change by no more than +/- 5%.