Vermont Legislative Joint Fiscal Office

One Baldwin Street • Montpelier, VT 05633-5701 • (802) 828-2295 • Fax: (802) 828-2483

FISCAL NOTE

Date: January 3, 2020

Prepared by: Mark Perrault and Chloe Wexler

Current-Law Education Fund Outlook for FY2021

On December 2nd, the Commissioner of Taxes submitted a letter to the Legislature that forecast an increase in education tax rates for FY2021.[1] The Commissioner's letter is intended to provide guidance to school boards preparing budgets for submission to voters in March.

	FY2020	FY2021	Increase
Average homestead property	$1.510	$1.567	$0.057
Average household income	2.47%	2.55%	0.08%
Uniform nonhomestead property	$1.594	$1.654	$0.060

There are three important caveats to note:

- These forecasted tax rates are based primarily on *estimated* per-pupil education spending; board-approved budgets will not be available until the end of January.
- As discussed below, the Education Fund (EF) is currently carrying an $8.2 million surplus that is not included in the Commissioner's tax rate forecast.
- The Legislature may enact policy changes during the upcoming session that could raise or lower the forecasted tax rates.

1. Education Fund Surplus in FY2020

Act 46 of 2019 required the Commissioner to disregard any undesignated surplus in the EF when forecasting tax rates for FY2021 only. However, the Legislature is free to use these nonrecurring funds to reduce tax rates next year.

The EF is currently carrying an estimated $8.2 million undesignated surplus in FY2020. Use of these nonrecurring funds in FY2021 would reduce both the homestead and nonhomestead property tax rates by almost one-cent.

2. Education Fund Revenue in FY2021

At the forecasted tax rates, recurring EF revenue is projected to grow nearly $84 million or by 4.7% over FY2020. Recurring EF revenue consists of dedicated nonproperty taxes and transfers and

[1] The Commissioner's forecast, made after consultation with the Secretaries of Administration and Education and the Joint Fiscal Office, is largely a ministerial task prescribed by law. See 32 VSA §5402b.

education property taxes. Education property taxes include the homestead property tax, the nonhomestead property tax, and the homestead property tax credit.

a. Growth in dedicated nonproperty taxes and transfers

Dedicated nonproperty taxes and transfers account for nearly one-third of EF revenue. According to the July revenue forecast, nonproperty taxes and transfers will grow by $14.6 million or about 2.6% over FY2020.

Growth in nonproperty taxes is largely driven by underlying economic conditions and, barring any policy changes enacted by the Legislature, are fixed as a practical matter once the January revenue forecast has been approved by the Emergency Board. At that point, any changes in statewide spending affect only education property taxes.

b. Growth in education property taxes and the property tax credit

Education taxes account for the remaining two-thirds of EF revenue. At the forecasted tax rates, the homestead tax would grow by $36 million or about 8.1% over FY2020 after the property tax credit is applied.[2] The nonhomestead tax would grow by $53 million or about 7.7% over FY2020.

Growth in the education property tax is driven primarily by statewide education spending, which is determined collectively by school boards and voters annually.[3] Note that when statewide spending grows faster than nonproperty taxes and transfers, the difference must be made up on the statewide property tax.

3. Education Fund Spending in FY2021

EF spending is forecasted to grow by $82 million or by 4.7% over FY2020 – well above the 2.6% rate of state and local government inflation. Salaries and benefits for teachers and support staff, which alone account for nearly four-fifths of education spending, are the primary cost drivers. Other cost drivers include special education and school construction.

a. School Employees' Health Insurance Costs

The cost of school employees' health insurance will be a significant driver of education spending in FY2021. Two factors are at play here: an increase in premiums and the implementation of a new statewide contract.

- *Premium Increase* – The Vermont Education Health Initiative (VEHI) filed its proposed FY2021 premium rates with the Department of Financial Regulation (DFR) in September. The overall rate increase for active employees will range from 12.9% to 14.9% depending on the plan chosen. These rates will not be final until approved by DFR typically in mid-January.

  According to VEHI, the premium rate increase is primarily due to three factors:

---

[2] The homestead property tax credit for FY2021 is set at $171.5 million, an increase of $3.5 million over FY2020. For eligible homeowners, the property tax credit is the difference between the education tax based on property value and the education tax based on household income *in FY2020*.

[3] For this purpose, education spending is generally defined as school budgets less any federal and state categorical aid.

(1) Inflation and utilization trends (6.5%)
(2) Pricing alignment (4.4%)
(3) Rebuilding reserves (2.0%)

- *Statewide Contract* – Act 11 of 2018 created a commission to negotiate statewide health insurance benefits for teachers and support staff. Negotiations were resolved through binding arbitration and the final plan was adopted on December 12th.

  Although it is not yet possible to fully determine the fiscal impact of this new contract, costs are expected to increase due to changes in eligibility, increased benefits for support staff, and changes in out-of-pocket mechanisms with first-dollar coverage for beneficiaries.

  The fiscal impact of the statewide contract will also vary between school districts based on existing district-level contracts for teachers and support staff as well as the response of employees to the new health care options.

b. Special Education Aid

Act 173 of 2018 was intended to simplify administration and reduce costs by changing the funding model for special education from a reimbursement model to a census-based model beginning in FY2021. However, its implementation was delayed until FY2022 last session.

For FY2021, the Agency of Education (AOE) will continue to collect full-service plans for special education students and reimburse districts for 60% of all special education expenditures. AOE estimates that this aid will cost $223.7 million based on service plans submitted in the fall of 2019 – an increase of $10.7 million or about 5% over FY2020.

Note that even once the census-based model is implemented, cost savings are speculative. Unless a district is able to reduce its federally-mandated special education spending, reduced aid may only serve to increase the district's education spending and tax rates.[3]

c. School Construction Costs

State aid for school construction is part of the State's capital bill. Until a moratorium was imposed in 2007, 30% state aid was available for approved school construction projects. Since then, only projects under $100,000 that are necessary to address immediate and unanticipated health and safety threats have been eligible for aid.

Despite the lack of state aid, recently several school construction projects have been approved and more will be submitted to voters for their approval this March. For example, voters in Burlington and Winooski approved bonds for $70 and $58 million, respectively, and South Burlington will reportedly ask voters to approve a $209 million bond this spring.

To put these figures into perspective, the Vermont Municipal Bond Bank (VMMB) has financed only $211 million in school construction loans between 2008 and 2019. Over this 12-year period, the VMMB made 87 loans averaging only $2.4 million per project. The amount of new borrowing over this period is likely a consequence of the moratorium.

Since districts have not made significant new investments over this period it is likely that the need is high. Districts may now be in a position where they need to address years of deferred maintenance. In addition, newly-merged districts may need to redesign or reconfiguring existing buildings as they adapt to Act 46. AOE is reportedly surveying districts to determine the status of school infrastructure across the state.

In the absence of state aid, the annual principal and interest payment on school construction debt will increase per-pupil education spending and homestead tax rates in districts that borrow. However, because the net homestead tax covers only about 32% of a district's spending on average, borrowing will have an impact on taxpayers in other districts as well.

4. Other Factors

Other factors that will affect education taxes and tax rates next year are the use of nonrecurring revenues, the availability of prior-year reversions, declining enrollment, and statewide growth in property values. Note that the last two factors affect education tax *rates* only.

a. Use of Nonrecurring Revenue in FY2020

In FY2020, the EF began the year with an undesignated surplus of $19.4 million. Of this amount, the Legislature used $11.2 million to support tax rates in FY2020.[4] These funds must be replaced from another revenue source in FY2021.

b. Prior-Year Reversions

The Administration will recommend reverting $8.3 million in prior-year appropriations to the EF in the Budget Adjustment for FY2020. Reversions have averaged $7.8 million annually over the past ten years, but are generally not included in EF projections until the prior fiscal year has closed.

c. Declining Enrollment

The pupil count has been steadily declining since Act 60 was implemented over twenty years ago. Although the rate of decline has slowed, AOE currently projects that the pupil count will decline by an additional 427 pupils in FY2021. Although there are districts with growing enrollments, the statewide trend is expected to continue.

d. Growth in the Statewide Property Values

In FY2021, statewide property values will grow by 3.0% over FY2020. While statewide property values now exceed their pre-recession level, slow growth continues and in some parts of the state values are lagging. While growth in property values does not raise and lower statewide education taxes, it does affect education tax rates.

[4] As discussed above, Act 46 of 2019 provided that any remaining undesignated surplus be retained in the Education Fund for possible use in FY2021.