Vermont Legislative Joint Fiscal Office

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PRELIMINARY FISCAL NOTE

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DRAFT

Preliminary Outlook for Education Tax Rates in FY19

32 VSA §5402b provides that by December 1st, the Commissioner of Taxes shall recommend current-law education tax rates for FY19. This recommendation is determined by the Commissioner after consultation with the Secretaries of Administration and Education and the Joint Fiscal Office. It is still early in the consensus process and more information will become available between now and December 1st. However, it appears that current-law education tax rates for FY19 may be significantly higher than actual FY18 education tax rates.

Note that the Commissioner's recommendation on December 1st 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 any increase in education tax rates in FY19.

1. Use of Nonrecurring Revenue Sources in FY18

a. Use of the FY17 Education Fund surplus

Over $26 million from the FY17 surplus was returned to taxpayers in FY18 through lower education tax rates. No surplus currently exists in FY18 for use in FY19, 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 FY19.

b. Use of the Education Fund stabilization reserve

Over $9 million from the stabilization reserve was used to lower education tax rates in FY18. By statute, the Commissioner's December 1st education tax rate recommendation must assume that the stabilization reserve is restored to 5% of prior-year net appropriations. Although the stabilization reserve may be reduced to 3.5% and remain within statutory parameters, the Treasurer has expressed concern that not fully restoring the stabilization reserve to 5% in FY2019 could jeopardize the State's bond rating. All else being equal, restoring the stabilization reserve to 5% will increase average education tax rates by roughly 1 cent in FY19.

2. Growth in Education Spending in FY19

a. Nominal growth in education spending

The cost of state and local government services is currently projected to grow by nearly 3% in FY19. Assuming that spending grows at that rate, statewide education spending will increase by more than $39 million in FY19. Actual growth in education spending will not be known until late January or February after school boards have submitted their proposed budgets to AOE. All else being equal, nominal growth of 3% in education spending will increase average education tax rates by roughly 5 cents in FY19.

b. Growth in VEHI teachers' health insurance premiums

According to VEHI, teachers' health insurance was underpriced in FY18 because 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 FY18 projected shortfall and to hold down rate increases in FY19. Nevertheless, VEHI has requested a significant increase in rates in FY19 ranging from 6% to 17% depending on the plan – actual rates will be determined by the Department of Financial Regulation early next year. We will not be able to estimate the full impact of higher premiums on districts until we have contract details and enrollment data later this year.

c. Recapture of assumed VEHI teachers' health insurance savings

Under current law, education payments will be reduced by $8.4 million in FY18 and $4.5 million in FY19 to recapture *assumed* teachers' health insurance savings. Districts that were unable to achieve these savings or cover the cost with local reserve funds or find savings elsewhere in their FY18 budgets will carry a deficit that must be addressed in FY19. We do not have detailed information on district spending, but any deficits in FY18 may show up as higher education spending in FY19.

d. Depletion of local reserves in FY17

Act 46 imposed per-pupil spending targets on districts in FY17 and FY18. To avoid the tax penalties levied on districts for exceeding their targets, many districts used local reserve funds to reduce their per-pupil spending. These spending targets were repealed for FY18, but it is unlikely that districts have been able to restore reserves for potential use in FY19. Any reserve funds used to cover spending in FY18 will need to be replaced from another revenue source. We do not have current data on districts' reserves.

3. <u>Other Factors</u>

a. Transfer of teachers' pensions to the Education Fund

The normal cost of teachers' pensions – nearly $8 million in FY18 – was transferred from the General Fund (GF) to the Education Fund (EF) in FY18. Roughly one-half of the cost of this transfer was covered with GF revenue: (1) in FY18, an additional $3.3 million was transferred from the GF to the EF; and (2) beginning in FY19, the EF allocation from the sales & use tax was increased from 35% to 36% or about $4 million in FY19. The remainder was partially offset by recognition of declining costs for correctional education. All else being equal, the cost of these decisions will increase average education tax rates by almost 0.5 cents in FY19.

b. Growth in special education aid in FY19

After three years of level funding, special education aid was underfunded in FY18. Consequently, the FY19 appropriation for special education aid will reflect two-years of growth. At more than $180 million annually, special education aid is the largest Education Fund use after the education payment. AOE will determine the amount of aid necessary to fully fund special education aid.

c. Slow growth in the property tax base

The value of the education grand list has now returned to its pre-recession level; however, growth in property values continues to be slow. Current projections indicate that statewide property values will increase by only about 1.4% in FY19 - 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.