

To: General Assembly
From: Mark Perrault, Joint Fiscal Office
Date: May 22, 2018
Subject Administration's 5-Year Education Finance Plan

As you requested, the following is a review and evaluation of the administration's *5-year Education Revitalization, Tax Stabilization & Investment Plan* as shared with you on May 18th by Commissioner Kaj Samsom.

JFO understands that the administration's proposal is still being revised, so this should be considered a preliminary analysis.

1. Maintaining Education Tax Rates at FY2018 levels in FY2019

- The administration's plan would maintain education tax rates in FY2019 at their FY2018 level and fully fund the stabilization reserve with one-time funds or a loan from the General Fund.
 - Since education spending was determined by voters in March, the administration's plan would require an estimated \$55 million in one-time funds in FY2019.
 - Use of one-time funds to artificially lower education tax rates in FY2019 would likely create a similar problem in FY2020; by the administration's own projections sent to us on May 22nd, an additional \$58 million in savings, one-time funds, or a loan would be required in FY2020.

H.911 Note: As passed by the Legislature, H.911 would allow the *average* homestead property tax rate to grow by 2.6 cents, the nonresidential property tax rate to grow by 5.5 cents, and full funding of the stabilization reserve.

- The Legislature would use \$9.8 million in one-time funds from the FY2018 revenue upgrade to fully restore the reserve in FY2018 and FY2019.
- The 2.6-cent increase in the FY2019 *average* homestead tax rate is commensurate with the statewide rate of growth in education spending.

2. The Administration's 5-Year Education Fund Outlook

- The administration's five-year forecast is primarily based on current law *except for holding education tax rates constant at their FY2018 levels.*

- The “Gap” line on the administration’s Education Fund outlook indicates that there is a \$250 million shortfall over the next six years to hold education tax rates constant and fully fund the stabilization reserve:
 - FY2019 - (\$55 million)
 - FY2020 - (\$58 million)
 - FY2021 - (\$54 million)
 - FY2022 - (\$45 million)
 - FY2023 - (\$23 million)
 - FY2024 - (\$14 million)

- The administration’s 5-year outlook is a *mathematical exercise* only; their analysis does not indicate specifically how this “gap” will be closed – whether through borrowing or anticipated savings.

- Under the administration’s proposal, if anticipated out-year savings cannot be achieved, the Education Fund will need additional resources.

- *Legislative Council has questioned whether borrowing would raise legal issues. The Treasurer has also expressed concerns about the use of a loan to fill the reserve.*

- Maintaining homestead tax rates at their FY2018 level for several years regardless of spending sends a wrong message to school districts.
 - Voter disapproval is the only signal school board members have that their proposed budgets may be too high.
 - Removing the tax consequences of voting for higher school budgets may result in even higher spending.

- In its May 1 memo to the legislative leadership, the administration has identified the following areas where savings may be achieved over the FY2020-FY2024 period:
 - A. Increase the student-to-staff ratio - \$262 million
 - B. New special education aid formula and service delivery - \$86 million
 - C. Statewide health care bargaining - \$62 million
 - D. Reduce excess spending threshold over 5 years - \$35 million
 - E. Reduce housesite value from \$500,000 to \$400,000 - \$11 million
 - F. Reduce property tax adjustments for new homesteads - \$4 million

Although the administration addressed double counting by discounting the theoretical savings attributed to lowering the excess spending threshold, JFO

remains concerned that additional double counting or overestimates may remain because each of the cost-saving provisions are interactive.

The administration's and JFO's estimate of future growth in education spending is low at 2.6% annually – a growth rate that already assumes some saving. If individual areas of savings are being booked separately, then the underlying growth rate should be higher.

Each of these cost-containment provisions is address below in items A - F.

A. Student / staff ratios

- The administration's estimate of potential savings from increasing the student-to-staff ratio over time was a mathematical calculation rather than a detailed analysis. Raising the student-to-staff ratio is by far the administration's largest source of savings.
- Savings would be achieved by increasing the student-to-staff ratio over five years with exclusions for some categories of employees such as special educators and employees that provide services that are often or could be contracted out.
- The administration believes that its staff-to-student ratio targets would be achieved over time through attrition; however, there is no mechanism proposed to require that any reduction in teachers or other staff is realized.
- Most observers agree that full implementation of Act 46 will likely increase the student-to-staff ratio. Act 46 will allow districts to achieve higher ratios through better management of teachers and staff in larger and more efficient governance structures. However, the administration's savings estimates may be overstated and may be delayed.

B. New special education aid formula and service delivery

- The census-based special education formula, that the administration supports, was adopted by the Legislature in H.897.
- Under that legislation, the special education aid allocation would be capped at its FY2021 level. This cap is not currently captured in the Education Fund outlook provided by the administration today.
- However, unless districts are able to successfully achieve spending reductions through the implementation of best practices, these savings may not be achieved. If districts are unwilling or unable to achieve these savings, these costs will be reflected in education spending.

- Most observers anticipate that H.897 will create savings in the long-term; however, JFO questions whether these savings will occur as soon as the administration assumes.

C. Statewide health care bargaining

- The Governor's May 1 proposal suggests that the cost to employers of school employees' health care would decrease by \$62 million over the period from FY2020 through FY2024. Which health care plan design leads to such savings is not clear. No proposal has been enacted; any actual savings would require legislative action. Therefore without any specific plan, any level of savings is difficult to assume.
- H.858 was considered by the Legislature and referenced by the Governor. Starting in FY2020, JFO estimates that the cost to employers of school employees' health care would increase by nearly \$43 million over the period FY2020 through FY2024; however, H.858 did not pass.
- The Governor's Target Plan was proposed in 2017. If implementation was required in FY2020, JFO estimates that the cost to employers of school employees' health care would decrease by \$44 million over the period from FY2020 through FY2024 – roughly \$18 million less than the administration's total assumed savings.
- VEHI has indicated that it will need to subsidize health care premiums in FY2019 by \$8 million.

Preliminary Findings from JFO's Analysis of the Total Cost to Employers of Various Health Care Plans for Public Education Personnel is attached.

D. Excess spending threshold

- The administration's plan would reduce the excess spending threshold from 121% to 110% over five years beginning in FY2020.
- The administration's estimates, based on FY2018 and FY2019 data, assume that all districts that would reduce spending to remain below the threshold amount; however, there are no assurances that districts would be able or willing to achieve these spending reductions.
- In addition, the commissioner's memo to you states that the administration discounted excess spending threshold savings to prevent double counting of the savings attributable to increasing the pupil/staff ratio; however, the rationale used to discount these savings has not been shared with JFO.

E. Reduce housesite value for property tax adjustment

- Both H.911 and the administration's proposal would reduce the housesite value limit for a partial property tax adjustment from \$500,000 to \$400,000 beginning in FY2019; however, this reduction is not reflected on the administration's current Education Fund outlook.
- This modification would lower the cost of the property tax adjustment by roughly 16 million over six years.
- **H.911 Note:** As passed, H.911 also includes a provision that would lower the housesite limit for a *partial* property tax adjustment from \$250,000 to \$200,000 reducing the cost of the property tax adjustment by over \$11 million. In a letter from the Governor received by JFO this morning, the administration proposes delaying this provision for a year if implemented.

F. Reduce property tax adjustment for new homesteads

- The administration's plan would make a number of changes to the current-law property tax adjustment for homesteads established after FY2019:
 - The maximum housesite value would be reduced from \$500,000 to \$250,000 minus the applicant's household income
 - Household income would be redefined to allow a deduction of \$4,000 for each exemption claimed on their personal income tax return
 - The homeowner rebate system would be modified by limiting the municipal property tax to 3% of household income for resident homeowners with household income under \$47,000
- The administration estimates that this modification to the property tax adjustment would save \$1 million in FY2019 and increase over time as home ownership changes.
- JFO has not analyzed this proposal; however, Legislative Council has questioned whether enactment of this provision would raise legal issues.

Note: This analysis is current as of May 22. Consequently, it may not reflect a final version of the administration's proposal.