

MORE
Municipal Tax Authority Working Group
Hartford, CT
April 18, 2013

Paul Cillo
Public Assets Institute

1. Introduction (1 minute) (Title Slide)
 - a. My name is Paul Cillo. I'm the president of Public Assets Institute. We're a Montpelier-based nonprofit, nonpartisan, public policy think tank that was established in 2003. We're in our tenth year.
 - b. In addition to our work on the state budget, taxes, and the Vermont economy, we work in three issue areas: education finance, health care finance, and family economic security
 - c. We regularly publish reports, fact sheets, and blog posts on our website www.publicassets.org.
 - d. I formerly served in the Vermont House of Reps for 10 year (1989-1998)
 - i. 4 years on the Ways and Means
 - ii. 4 years as Majority Leader
 - e. I worked for most of my time in the Legislature on school finance
 - i. That work led to passage of Act 60 in 1997, which fundamentally changed the way we pay for schools in VT
2. Presentation overview
 - a. Provide some background on school funding in Vermont
 - b. Explain the fundamentals of Vermont's school funding system
 - c. Provide some analysis of school spending, taxes, and tax distribution in Vermont
3. Background
 - a. School districts
 - i. School districts vote their budgets separate from municipalities
 - ii. State law requires school district budget approval by district voters
 - iii. School tax rates are expressed in dollars per \$100 of grand list; not as a mill rate
 - b. State aid
 - i. Vermont has had a number of formulas over the past 50 years
 1. Traditionally formulas were changed about every 8-10 years as the share of state funding dropped and property taxes rose to unacceptable levels.
 2. State aid formulas typically are structured so that town-to-town tax disparity increases as the state share of education funding decreases.
 - ii. In 1988, Vermont enacted a Foundation formula
 - iii. In 1997, that formula was declared unconstitutional by the Vermont Supreme Court (Slide)
 - iv. Act 60 was signed into law on June 26, 1997; it was amended in 2003 by Act 68, which is now the school funding law.
 - c. Key issues
 - i. Legislative support for state aid

1. It will increasingly difficult to get a majority of legislators to support increased state aid, because a minority of districts benefitted from the additional aid. The problem was hold-harmless and similar provisions that insulated districts from changes in state funding.
 2. Act 60 was designed so that all Reps. and Sens. were in the state "boat" so an increase in General Fund support meant lower property taxes for all districts.
- ii. Local control
1. Vermont is committed to local control
 2. Act 60 was designed to preserve local decision making while equalizing the tax base used to pay for schools.
 - a. The system is structured so that the same spending per pupil in any two towns, results in the same school tax rates in those towns.
- iii. Security of statewide property tax revenue
1. There was concern that if the state got its hands on the property tax it would use it for purposes other than pre-K to 12 public education.
 2. Act 60 created a new Education Fund. All the statewide property tax revenues go into the fund along with a General Fund appropriation and some non-property tax dedicated revenue (1/3 of sales tax, lottery proceeds, etc.)
 - a. Law states that if the statewide property tax is used for a purpose other than pre-k to 12 public education, the statewide property tax is repealed.

4. Act 68 Fundamentals

- a. (Click) First we're going to look at the fundamentals of how Act 68 works compared to the Foundation system. Keep in mind that there are a lot of intricacies in Act 68 that I'm not discussing here because the goal is to understand the fundamentals. Too often discussions about school funding get down in the weeds without a broader understanding of what the system is actually doing.
- b. Set up
 - i. I'm going to use a one-page chart for this explanation.
 - ii. (Click) On the right side of the chart, you'll see information about Act 68; on the left is Foundation.
 - iii. For this illustration we're using two example towns, one a property wealthy town, Town A (Click), the other is a property poor town. Town B (Click). What makes a town wealthy or poor for school funding purposes is the town's property tax base per pupil.
 1. Wealthy towns have a large tax base with few students; poor towns have a relatively small tax base often with many pupils.
 2. These example towns are not the wealthiest or the poorest towns in the state.
 3. We'll look at what happens to taxpayers in these two towns--first under Foundation, then under Act 68.
 - iv. In this example, we assume spending in both towns with both funding systems to be \$13,000 per pupil (Click) with three basic spending components:

1. Base Amount: (Click) It used to be called the Foundation Amount. The Foundation Amount was the spending per pupil that the state said was adequate for meeting the Public School Approval Standards.
 - a. The Base Amount is not thought to be adequate; this component is a holdover from Foundation that is now used to calibrate the system.
 - b. We're assuming \$9000 per pupil for the Base or Foundation Amount. This is close to the \$8723 base amount for the this year, but is an easier number to work with.
2. Next is Categorical Aid: (Click) This is aid that under both Foundation and Act 68 is provided by the state to school districts based on category of spending, not financial need.
 - a. Examples are special education and transportation.
 - b. We're assuming \$1000 per pupil.
3. Finally, Above base spending: (Click) Just as it's name suggests, this is spending per pupil that is above the Base Amount. This example assumes \$3000 in spending above the base amount.

c. Foundation

- i. Let's look at how the Foundation system works first.
- ii. Under Foundation, in essence the state guaranteed that any town could spend up to the Foundation Amount per pupil (in this case \$9,000) with a local property tax rate of no more than the Foundation Tax Rate, which for example we'll say is \$1.20. This rate was set by the Legislature each year.
 1. State aid was given to towns that, without the aid, would have required tax rates higher than \$1.20 to cover the \$9000 per pupil Foundation Amount.
 2. Any spending above the Foundation Amount, other than Categorical aid, needed to be covered by the town's tax base without additional state aid.
 - a. I should note at this point that the tax base we're referring to here is the entire tax base of the town including both residential and non-residential property.
- iii. Looking at Town A, the property wealthy town, first
 1. (Click) It could raise the \$9000 per pupil with a \$.60 tax rate. Since that's below the \$1.20 Foundation Tax Rate, so Town A did not get state aid.
 2. (Click) This town gets the \$1000 per pupil for categorical aid.
 - a. And by the way, the filled-in blue areas on the chart represent local property tax funding; the white areas state funding.
 - b. The \$9000 was raised on the town's local property tax; the \$1000 was provided by the state.
 3. And for the \$3000 that the town voted to spend about the Foundation Amount, (Click) Town A would need to put an additional \$.20 on the tax rate.
 4. Town A's total tax rate is \$.80 (Click).
- iv. Now let's look at Town B

1. It requires a tax rate double that of Town A to raise only half the money per pupil. (Click) Town B can raise \$4500 per pupil with a tax rate of \$1.20.
 2. Remember the state said that the town can spend the full \$9000 per pupil with a tax rate of no more than \$1.20. So the state would pay the town the balance, \$4500 per pupil as state aid. (Click)
 3. Like Town A, this town gets the categorical aid from the state. (Click)
 4. But for the remaining spending above the Foundation Amount, Town B like Town A is on its own. Town B requires another \$.80 on the tax rate (Click) to raise the additional \$3000.
 5. Town B's total tax rate is \$2.00 for the same spending per pupil as Town A. (Click)
- v. This disparity in tax effort—\$.80 in one town and \$2.00 in another for the same spending per pupil—is what the Vermont Supreme Court saw in 1997 when it issued the Brigham Decision, declaring the Foundation system unconstitutional.
1. But keep in mind that these tax rates don't represent the most extreme disparity. In the 1990s, the town of Stratton had a school tax rate of \$.03 for higher per-pupil spending than the town of Stannard with a tax rate of \$3.30—more than 100 times higher.
 2. Also, I want to point out here that under Foundation if the Legislature appropriated less money for state aid, the disparity between towns like these increased, because more of the spending would have to be above the Foundation Amount where the towns were on their own.
- d. Moving to Act 68, we'll see what the state did to remedy this situation.

I want to step outside the chart for minute to give you some explanation here because Act 60 and Act 68 didn't simply create a new state aid formula. They changed—in four fundamental ways— (Click) how Vermont funds its schools.

- a. First of all, Vermont schools are no longer funded with local property taxes. All taxes to support our schools, including property taxes, are state taxes and rates are set based on the statewide, not local, tax base.
 - i. While property taxes are still collected locally, towns are acting as collection agents of the state much the way that businesses collect payroll or sales taxes and remit them to the state.
 - ii. All taxes collected for schools in Vermont go to the state Education Fund.
- b. Secondly, under Act 68 the residential and non-residential statewide tax bases are separate. The state levies a statewide rate on all non-residential property—land, business, and second home property. That rate is the same in every town.
 - i. The statutory rate is \$1.54. But each year the Legislature has been setting the rate below that amount because property values have increased faster than school spending since 2003 when Act 68 was passed.
 1. The rate for the 2012-13 school year set last summer is \$1.38 on the fair market value of all non-residential property in the state.

- ii. So the only school tax rates directly affected by school district budget votes are taxes on primary residences. The numbers you'll be looking at in this chart under Act 68 affect only primary residences in the Towns A & B.
- c. Third, Vermont residents can choose to pay the school taxes on a primary residence and up to 2 acres of land based on their household income or on the value of the property.
 - i. So there are two rates for each town for the base amount of spending: one is the statutory \$1.10 for property, the other is 2% of income.
 - ii. About two-thirds of Vermont homeowners choose to pay the school taxes on their primary residence based on their household income.
 - iii. And just as the Legislature has lowered the non-residential rate because property values have risen rapidly over the past decade, residential base rates have also been lowered.
 - 1. The base rates set by the Legislature for 2012-13 are \$.89 on the fair market value of primary residences or 1.8% of household income.
 - iv. These base rates are also the minimum rates. So for towns that spend less than the base amount per pupil, residential taxpayers would still pay these base rates.
- d. Finally, a big difference between Foundation and Act 68 is that all school district spending is equalized. Unlike Foundation where spending above the Foundation Amount left the town on its own to pay for it. Under Act 68 every town has the same tax rates for the same spending per pupil regardless of how much the town votes to spend.
- ii. So back to our chart, (Click) under Act 68 with Town A, the town has a tax rate of \$1.10 on property to cover the base amount of \$9000 per pupil or 2% of household income. (Click)
- iii. Categorical aid works the way it did under Foundation, though the kind of aid that is provided and the level of aid has changed under Act 68. (Click)
 - 1. For example, transportation aid is now categorical aid; which was new with Act 60.
- iv. The tax rate for spending above the base amount is simply proportional to the increase in spending. (Click)
 - 1. In this example, spending above base is one-third more than base spending, so the tax rates on both property and income go up by one-third compared to base tax rates.
 - a. One-third of \$1.10 is \$.36; one-third of 2% is .67%.
 - b. There is no limit on how much a school district can spend per pupil. But the more the district spends per pupil, the higher the tax rates the district residents will pay.
 - 2. As voted spending per pupil goes up in a town, both income and property rates go up in that town.

- a. The property tax rebate program which has been in place in some form since the 1970's does cap municipal and school taxes at a certain percentage of income for households with incomes of \$47,000 or less.
 - v. So the total tax rates for Town A would be \$1.46 on the fair market value of primary residences or 2.67% of household income.
 - vi. For Town B, since we're assuming the same spending per pupil as in Town A, the tax implications are identical as they are for Town A (Click).
 - 1. The bottom line is that under Act 68 in any two towns where education spending per pupil is the same, the tax rates—on property or income—will be the same, and therefore similarly situated taxpayers will be treated the same regardless of the town they where they live.
 - 2. The tax rates on property are based on fair market value. That brings me to the next point I want to make.
 - vii. Common Level of Appraisal or CLA (Click)
 - 1. Towns cannot afford to reappraise every year and list all properties at their current fair market value, so the state does an annual statistical analysis to determine how far above or below fair market value each town is.
 - a. The state has been doing this for decades because state aid under Foundation —and formulas before Foundation —were based on fair market value in every town.
 - b. The income rate is unaffected by the CLA since the CLA applies only to property taxes.
5. Let's move on to some analyses of Act 68 (Click)
- a. Vermont's per-pupil spending in recent years ranks among the top five states. It's also true that Vermont's student test scores rank among the top five states in the country.
 - i. But the funding system has incentives to keep spending down built right into it.
 - 1. First of all, as I said earlier, a town's residential tax rates increase on both property and income if a town votes to spend more per pupil.
 - 2. And secondly, for high-spending towns, there is what's called an "excess spending threshold". Any education spending above this amount per pupil increases the town's tax rate twice as fast as spending below the threshold. (Click)
 - 3. The VT Dept of Education calculates this number each year based on a statutory formula that is about 125% of the previous year's statewide average education spending per pupil.
 - 4. The threshold for this year is \$14,841 per pupil. For next year it will be \$15,456.
 - ii. But the biggest criticism we hear about spending is that the growth rate of Vermont's school spending has sky rocketed and is unsustainable.
 - iii. So I want to talk with you what the data show. (Click)
 - iv. This chart shows growth rates in school spending from 2005 on the left to 2013 on the right.

1. You can see that the growth in statewide education spending was more than 6 percent in 2005.
 - a. We expected some elevated growth rates after passage of Act 60 in 1997 as school districts that had been spending too little began to catch up. This happened in the 1980s, too, when Vermont made a commitment to increase teachers' salaries when Vermont's salaries ranked near the bottom nationally. We had elevated growth rates in spending for a time, then it leveled off.
 - b. I think we're seeing something similar here. What we see in this chart is that even before the recession took hold in 2008 and 2009, growth rates in education spending were already coming down.
 - c. Once the recession hit, the trend continued down to the point where in 2011 and 2012, education spending was actually lower than the previous year's.
 - d. Spending went up in 2013, as you'd expect after two years of severe budget cuts.
 - e. But you can hardly call this unsustainable spending growth.
- v. Another way to assess whether growth is sustainable is to look at in the context of economic growth. (Click)
- vi. I'm going to compare growth in statewide expenditures for health care with growth in statewide expenditures for pre-k to 12 public education. (Click)
- vii. We'll look at growth in expenditures as a percentage of the economy between 1992 and 2010, nearly two decades. The vertical axis is percent of gross state product.
 1. First health care (Click)
 - a. Total health care expenditures on behalf of Vermont residents grew from a little over 10 percent of the economy in 1992 to nearly 20 percent in 2010. Costs that grow faster than gross state product can be thought of as unsustainable because economic growth is not enough to cover the additional costs each year. This line shows spending growth that is clearly unsustainable.
 2. Now let's look at school spending (Click)
 - a. For nearly two decades, Vermont's spending for pre-K to 12 public education has been between 5 and 6 percent of gross state product. This essentially flat line is the definition of sustainable spending.
 - b. I should note that over this same period Vermont's student population has gone down — about 1% per year. Some would say that spending should go down as the number of students goes down.
 - i. That may be true, though, I would point out that as the number of pupils has dropped, costs like those unsustainable health care costs—that schools need to pay —have gone up.
 - ii. But my main point here is that regardless of the number of students currently in Vermont schools, growth in

spending on Vermont's school system is economically sustainable.

- viii. The concern about spending increases usually stems from a concern about increases in school taxes. That's understandable. The system is designed so that those voting on school budgets are the ones who get the tax bills. But there are actually four factors that work together to make tax bills in a town go up or down. (Click)
 - 1. First is the school budget. Higher budgets put upward pressure on taxes.
 - 2. Second, is the number of pupils. Tax rates are directly proportional to education spending per pupil so if the number of pupils goes down, your spending per pupil goes up and your tax rate goes up even if your voted spending was the same as last year.
 - 3. Third, the CLA. If property values go up in your town, the CLA will adjust the tax rate up to account for the increased values and town residents will likely pay more.
 - 4. Finally, there is the General Fund transfer to the Education Fund and other dedicated non-property tax revenue. This can be invisible to communities because it happens in Montpelier.
- ix. Let me show you what I mean. (Click)
 - 1. In 2005, General Fund and dedicated revenue accounted for 39% of the revenue to the Education Fund, which funds pre-K to 12 public education in Vermont. That left 61% to be picked up by property taxes.
 - 2. This year, support from the General Fund and dedicated revenue is down to 33%, leaving 67% to the property tax.
 - 3. What this means is that the property tax not only needs to cover its share of any increase in school costs; it also needs to cover the decrease in General Fund support. That's one of the main reasons why school taxes have gone up faster than school spending.
 - 4. If the state had maintained the 39% share of funding to the Education Fund in 2013, property taxes would have been \$76 million lower this year.
- x. Finally, I want to talk a little about how school taxes affect people at different income levels. (Click)
 - 1. Even with so-called income sensitivity in place—the provision that allows homeowners to pay their school taxes based on their income—school property taxes are still regressive, that is, those with higher incomes pay a smaller share of their income in school taxes. (Click)
 - 2. This is an analysis done by the Vermont Tax Department. At the bottom of this chart are different income groups—lower income on the left to highest income on the right. (Click)
 - 3. The bars show the number of households in each income group. The vertical axis on the right provides the scale for these bars. You can see that most households are in the lowest three income groups (those on the far left) with incomes of less of \$100,000. The far left group with incomes of \$25-50,000 has about 48,000 households, the next group has about 42,000, and so on. All of these households in the first three

income groups would qualify to pay school taxes based on their income.

4. Now I'm going to show you the percentage of income that the median household would pay in school taxes without income sensitivity. Median means that half of the households in that group pay more and half pay less. (Click)
 - a. Using the scale on the left, what you see here is that the lowest income households would pay 5.5% of their income while the wealthiest households pay a half a percent of theirs or less than one-tenth of what the lowest income households would pay.
 - b. Now let's look at what happens as a result of income sensitivity. Technically any household can pay based on income, but as a practical matter, those with incomes of more than about \$100,000 are better off paying the property tax without income sensitivity. (Click)
 - c. This amber line shows that income sensitivity takes much of the bite out of school taxes by bringing the median households in the three groups with the lowest income down to about 2.8% of income. This is still more than 5 times that paid by the wealthiest.
5. We have suggested that a system that completely eliminated school property taxes on primary residents would be fairer to everyone and could bring the rates paid by all groups to between 2 and 3 percent of income. It would also eliminate the problems with confusion about the CLA discussed earlier if there were no longer a property tax on schools. Something to think about.