

Vermont's Education Funding System

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Finance & Administration

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OVERVIEW OF GENERAL EDUCATION FUNDING SYSTEM

As a result of the Vermont Supreme Court Brigham decision of 1997, Vermont now provides total state funding to its school districts. Prior to this court decision Vermont used a foundation formula to provide state aid to augment local school district property taxes.

In its simplest terms, this state funding system replaced the state aided local tax system. The state now pays each district the amount needed to fund the district's locally adopted budget through an education fund. This amount funded by the state equals the total voter approved expenditure budget less any amounts for expenditures that have specific funding. Examples of specifically funded amounts include federal programs and state categorical grant programs such as special education reimbursement aid. The state funded portion is called the district's "education spending."

The state then divides each district's education spending by the district's equalized pupil count. The equalized pupil count uses a weighting system for various student types. The resulting spending per pupil amount for a district is used to determine the district's homestead-state-education- property tax rate. The rates start at a base level associated with a base per pupil spending amount, then increase proportionally at higher per pupil spending amounts. A district with a per pupil spending amount 20% above the base will have a tax rate 20% above the base tax rate.

The resulting school tax rates for residents will apply to one of two tax bases. The homestead education property tax rate is applied as a percentage to a resident's homestead market value. The second rate is applied to the household income of those living in the homestead. The second rate is for households with incomes of \$90,000 or less as an alternative to the property tax should that method yield a lower tax bill.

The system is intended to apply pressure to voters if they approve spending amounts that result in high per pupil spending. If the voters in a district approve a budget that produces higher per pupil spending, the voters will have higher tax rates.

Regardless of the level of spending approved by the voters, property taxpayers with homesteads of the same market value living in districts that have the same per pupil spending amount, pay the same tax within the tolerances of the system. That is, if two districts have the same per pupil spending amount, the tax rates will be the same and taxpayers with the same market value homestead or household income will have equal tax bills. This taxing system provides the equity to Vermont's school funding system.

One complexity is a local adjustment to the homestead property tax rate. This adjustment is necessary because it is difficult for towns to keep properties listed at the current market value. Applying state rates to property listings that vary significantly from market value would produce unequal taxing. Each year, the tax department establishes a "common level of appraisal" or CLA for each town. Homestead tax rates are then adjusted by the town's CLA so that tax amounts will be equalized.

The following description of Vermont's education funding system is intended to describe the basic process. There are many technical details that go beyond the scope of this presentation.

Basic Funding

Under Act 68 of 2003, the state’s Education Fund provides money to school districts in two major categories: **categorical grants** and the **education spending** portion of school district budgets. These amounts total more than \$1 billion. Union districts were included in FY 2009 for the first time as a result of Act 130 of 2004. Prior to that, they were funded by assessments to member town school districts.

What Are State Categorical Grants?

State categorical grants are separate grants distributed for specific purposes from the education fund in certain spending categories. Examples of Vermont’s categorical grants for FY 2014 are listed below:

Special Education Aid (about 60% of eligible special education)	\$163,454,037
Transportation Aid (about 44% of transportation expenditures)	\$16,775,000
Small School Grants	\$7,491,286
Aid for State-placed Students	\$15,100,000
Technical Education Aid	\$13,274,423
Essential Early Education Aid	\$6,141,155
Total	\$222,235,901

What Is “Education Spending”?

Act 68 pays for all of a district’s education spending. How is this amount determined? Education spending is that part of an expenditure budget without a specific funding source. It includes the portion of special education costs not covered by federal aid or the state categorical grant, transportation costs not covered by the state categorical aid, as well as any tuition owed by the district, plus general payroll and operation costs that do not have specific funding sources. See 16 VSA § 4001(6) for the legal definition. Operationally it is determined as shown below.

$$\begin{aligned} & \text{Budget adopted by school district (town, city, union, incorporated)} \\ & + \text{Deficit from prior year (if any)} \\ & \hline & \text{Total District Budgeted Expenditures} \end{aligned}$$

$$\begin{aligned} & \text{Total District Budgeted Expenditures (town, city, union, incorporated)} \\ & - \text{State categorical grants, federal revenues, tuition revenues, interest income, etc.} \\ & \hline & \text{Education Spending} \end{aligned}$$

In FY 2014, education spending statewide is about \$1.216 billion, or 78% of total PK – 12 spending (total spending includes spending from other sources such as federal and categorical grants).

How Is Education Fund Money Raised?

The amount needed in the Education Fund to pay for categorical grants and education spending is about **\$1.460 billion** in FY 2014. Revenue estimates for the Education Fund sources in FY 2014 are given below.

• Nonresidential Education Property Tax	\$546 million
• General Fund Transfer	\$289 million
• 35% of Sales & Use Tax	\$125 million
• One-third Purchase & Use Tax	\$29 million
• State Lottery	\$23 million
• Medicaid Reimbursement	\$7 million
Total raised	\$1,019 million

Where’s the Missing Money? The Variable Homestead Property Tax Rate

The amount raised above is shy of the \$1.460 billion needed to pay school districts. One significant revenue source has been left out to highlight an important component of the system. All of the above revenue sources are raised through a fixed tax rate throughout the state applied to the indicated tax base. The source left off the above list is the homestead property tax. This tax provides the balance of the funding, about \$424 million. The homestead property tax rate varies proportionally with a district’s education spending per pupil. The pupil count used in this determination is called the “equalized pupil” count and uses weighting for different types of pupils. The details of the equalized pupil count are discussed in a separate paper.

The added amount from the homestead property tax still leaves the fund short about \$17 million in FY 2014. The balance will come from the education reserve fund which maintains a balance according to the provisions in 16 VSA § 4026.

What is a Homestead?

32 VSA § 5401(7) provides the legal definition of a homestead. The basic components are given below.

- “[T]he principal dwelling owned and occupied by a resident individual...”
- Includes, “parcel of land surrounding the dwelling....”
- “[D]etermined without regard to any road which intersects the land.”

How Are Homestead Tax Rates Determined?

A district’s education spending is first divided by its equalized pupil count to determine the district’s average education spending per equalized pupil. This amount is compared to the state’s base education spending amount per pupil to determine the percent variance. The base amount is set each year by the Legislature and is \$9,151 in FY 2014. The variance percentage is applied to the state’s base homestead tax rate to get the district’s tax rate.

For example, if in FY 2014, a district’s education spending per pupil is \$10,066, its spending per

pupil would be 10 percent greater than the \$9,151 base amount. The base homestead tax rate, which is \$0.94 in FY 2014, is then increased by the same percentage (10 percent in this case), resulting in a rate of \$1.03. All districts that have the same education spending per equalized pupil will have the same homestead tax rate. Homestead property tax rates cannot be lower than the base rate even if the district spends less than the base amount.

Most homestead taxpayers can get all or a large portion of their homestead property taxes adjusted so that the taxes are more reflective of income rather than property value.

Act 130, Union School Funding

Until FY 2009 union school districts were not recognized as districts in Chapter 133 of Title 16, the education funding chapter. This meant that until then union school districts did not receive education spending funding from the state, did not have a cost per equalized pupil, and did not have a tax rate. Union school budgets were, and still are, determined by a district vote, either using Australian ballot or floor vote at the union district annual budget meeting. To receive funding, these districts assessed costs to member town districts. The homestead tax rate for town districts that were members of a union district was a combination of the town district budget and the union district assessment.

That system led to some confusion because two or even three school boards were responsible for one cost per equalized pupil and it was next to impossible to break out the components. Put another way, it was hard to tell who was doing what to whom. Also, the law currently permitted union schools to assess costs to member town districts using any number of apportionment methods while funding was provided on an equalized pupil basis. This resulted in some members of the union being overcharged while others were undercharged.

Under Act 130, union districts are recognized in the funding law. These districts no longer assess costs to member districts but receive money from the state's Education Fund as do the town and city school districts. Beginning in FY 2009, union districts determined an education spending per equalized pupil amount and a corresponding homestead tax rate.

To understand how Act 130 works it is necessary to understand the distinction between governing entities. Towns or cities raise the homestead property tax on behalf of the state. These are taxing entities. School districts, town, city, or union districts are educating entities and do not raise taxes. The homestead tax rate levied by a town will be based on the average education spending per equalized pupil of all the pupils living in the taxing entity.

In a K-12 district such as Rochester, all of the students in the taxing entity (the town) are members of just one school district. In a town associated with a town district and a union district, some of the pupils living in the town (the taxing entity) are members of the town school district and some are members of the union school district. The tax rate for the taxing entity (the town) will be the average tax rate (weighted average) of both districts.

If 60% of the pupils living in the town of Shelburne are members of the Shelburne Town School District, and the tax rate determined for that school district is \$1.30, then 60% of that rate will be applied by the town of Shelburne or \$0.78. If 40% of the students are members of the union district and its tax rate is \$1.40, then 40% of \$1.40 or \$0.56 will be applied by the town of Shelburne. The total tax rate for the town of Shelburne will be \$0.78 + \$0.56 or \$1.34.

60% x \$1.40 (elementary district rate)	=	\$0.78
40% x \$1.50 (union district rate)	=	\$0.56
<hr/>		
Town of Shelburne homestead equalized tax rate	=	\$1.34

What Are Homestead Tax Adjustments? (Formerly Prebates or Income sensitivity)

The homestead tax for eligible payers will be reduced by an amount equal to the following:

- A. If household income is \$90,000 or more, the property tax on the first \$200,000 of housesite market value (house and up to two surrounding acres) minus the applicable percentage of the household income.
- B. If household income is less than \$90,000 the homestead property tax on the first \$500,000 of housesite market value minus the applicable percentage of the household income.

The applicable percentage of household income rate starts at 1.80% in FY 2014 and increases proportionally as the amount education spending per pupil exceeds the base amount the same way the homestead property tax rate increases. Beginning with the fall of 2007, adjustments are determined based on the prior year’s income and homestead tax and are applied to an individual’s property tax bill. This change ended the prebate program and checks are no longer sent to taxpayers. Tax bills are reduced directly by the adjustment amount from the prior year so eligible taxpayers see a reduced property tax bill.

Homestead Tax Rate Examples

The table below shows examples of tax rates using an \$9,151 education spending per equalized pupil base amount. For FY 2014, the base homestead rates are 1.80 % of household income and \$0.94 per \$100 of homestead market value.

Education Spending per Equalized Pupil	Percent of Household Income	Homestead Property Tax Rate
(Base) \$9,151	1.80%	0.94
\$10,066	1.98%	1.03
\$10,981	2.16%	1.13
\$11,896	2.34%	1.22
\$12,811	2.52%	1.32
\$13,727	2.70%	1.41

What is Nonresidential Property and How is this Tax Raised?

Nonresidential property is any property that is not a homestead with certain exceptions. See 32 VSA 5401(10) for statutory definition.

The property tax rate for all nonresidential property in the state is set in 32 VSA § 5402(a)(1). This rate is \$1.59 for each \$100 of fair market value.

Annual Adjustments to Statutory Tax Rates

Each December 1 the Tax Commissioner recommends adjustments to the \$1.59 nonresidential tax rate and the \$1.10 homestead tax rate based on the following:

- projection of the amount in the education fund reserve, and
- the nonresidential rate must produce at least 34 percent of education fund spending.

For FY 2014 the legislature set the nonresidential tax at \$1.44 and the base homestead tax rate at \$0.94.

Does the Law Limit Education Spending?

The law does not limit how much a district can spend. That amount is determined by the district board of directors and the district voters. However, districts with education spending per equalized pupil exceeding a prescribed amount, the threshold, will be subject to an increased tax rate. This is one of the provisions made to help constrain education spending. The increased rate is determined by adding to the district's education spending per pupil the amount that education spending per pupil exceeds the limit.

The High Spending Threshold by statute was 25% above state average education spending per pupil for the prior year. In FY 2013 the state average education spending per equalized pupil was \$12,365. Increasing this by 25% for the FY 2014 threshold sets the amount at \$15,456. In the 2013 session the legislature has lowered the threshold percentage for FY 2015 and 2016 to 23%. Beginning in FY 2017 and after the threshold percentage will be 21%.

In determining whether a district is spending over the threshold, the law provides eight various adjustments to a district's per pupil spending amount to recognize certain unavoidable drivers to the spending. The drivers include things such as particular special education costs, unexpected tuition payments required of the district, and certain capital debt service expenditures.

Excess Spending Example

In FY 2014 the threshold limit is \$15,456 per equalized pupil. The illustration below shows the tax rate that would result both with and without the limit for a district with education spending per pupil of \$15,756 using the FY 2014 base amount of \$9,151 and base rate of \$0.94.

	Threshold	Education Spending per Equalized Pupil	Amount Above Threshold	Amount Per Pupil Used for Tax Rate	Equalized Tax Rate	Percent of Household Income
Example if there were no excess spending provision	None	\$15,756	0	\$15,756	\$1.62	3.10%
Example with excess spending	\$15,456	\$15,756	\$300	\$16,056	\$1.65	3.16%

What Is CLA and How Is It Used? The CLA Paradox.

The CLA or **common level of appraisal** for each town is determined each year by the Tax Department’s division of property valuation and review (PV & R). PV & R compares property values listed by a town in various categories to actual sales data (over the past three years) for each particular type of property. Using actual sales data and statistical analysis PV&R determines how close a town’s education grand list is compared to its value if all properties were listed at 100% of fair market value. It expresses this CLA as a percentage. The education grand list adjusted by PV&R is called the equalized education grand list.

To ensure that state education property taxes are all assessed on the same basis, the tax commissioner is directed by law to set the tax rates in each municipality (see 32 VSA § 5402) by dividing tax rates for nonresidents and homesteads by the municipality’s CLA. For example, if the education spending per pupil in a district for FY 2014 is \$11,896, the homestead tax rate from the table above would be \$1.22 (1.22% of the market value). If the CLA in that town was determined to be 80%, it would indicate that the town’s grand list was 80% of market value instead of 100%. The tax commissioner would divide \$1.22 by 80% and get a tax rate for that town of \$1.525 to adjust for the CLA variance from 100%. The \$1.525 rate would appear on the town’s tax bills.

All towns that have the same education spending per pupil with the same CLA would have the same tax rate appearing on the tax bills. More likely, even if per pupil spending amounts were the same in two towns, the CLA for each would not be the same and the tax rates on the tax bills would be different. This apparent difference, however, is caused by the adjustment meant to equalize tax effort among towns where per pupil spending is the same.