FROM THE EXECUTIVE DIRECTOR –
WHEN CHICKEN LITTLE BECOMES CARNAC THE MAGNIFICENT

Usually, when we write negative or doubting words about our state government, we almost always look forward to being proven wrong. Such was the case in 1997 when we wrote "Top Five Reasons Why *Not* a State Property Tax" in the opening *Weekly Legislative Report*. In the article, we listed Reason Number 5:

> *There is No Way to Prevent the Legislature From Using State Property Taxes Collected for Expenditures Other Than Education Financing.*

This concern was raised a month before the *Brigham* decision was issued and six long months before Act 60 was signed into law.

Fast forward to the fall of 2002. With the recent $9.3 million rescission of state funds for education and the administration's proposed cut in the predictable yield, all we need to do is to add the Governor to the above prognostication and suddenly we are Carnac the Magnificent.

It is doubtful that the administration and Legislature would ever be so bold as to actually transfer property tax dollars to fund state General Fund expenditures. This is because 16 V.S.A. § 4025(d) reads "upon withdrawal of funds from the education fund for any purpose other than those authorized by this section, chapter 135 of Title 32 (education property tax) is repealed." However, the stage is set for the same outcome to be achieved, but through more roundabout means. Here's how it goes.

The State now estimates what it thinks is the growth in the grand list each year. Every year, new construction adds a small amount of new real property to be taxed. However, the value of existing real estate property changes from year to year as well. Unless a property actually is sold in an "arms-length" sale, there is no way to know exactly how much a property is actually worth. In order to make an educated guess as to a property's value, towns must occasionally do a revaluation where an assessor visits each property and studies replacement costs, potential income that a property could fetch if rented, and, most importantly, sales of comparable properties. As towns only reappraise every four or five years, the State annually makes its own estimate as to the change in value of each town's grand list, based on its own sales studies.

Through this process, the Division of Property Valuation and Review determined that the grand list of the State grew 6.6% last year and is projected to grow between 7.1% and 8% this year. The State does not break down how much of this growth is due to "new sticks and bricks" (new construction) and how much is appreciation of existing properties. An estimate is that perhaps as much as 3% is new construction and the balance is in appreciation. That means that for the average house that was listed on a town grand list at $100,000 and that was its fair market value in 2000, for tax purposes in 2001 it should be taxed at a value of $103,600. As towns don't reappraise every year and as the State can't reappraise properties, the State adjusts each town's "common level of appraisal" (CLA) every year and adjusts its education property taxes (statewide and local share) accordingly. For example, last year the State adjusted the total education tax rates an average of six cents (from $1.70 to $1.76) to account for its assumptions for the increased value of existing property.

Not only does this automatically increase the tax bill of property taxpayers, it also is swelling the coffers of the state Education Fund. A 6.6% increase in the state grand list will increase the funds from the statewide property tax by a comparable amount. Those funds go primarily to fund the per-pupil block grant ($5,566 this year). However, the number of students statewide is declining and the state increases the block grant amount per pupil only by the rate of inflation (projected at only 2.1% for next year).

If, by now, you are thinking, "uh oh" (and you are still with me), you are on the right track. The statewide property tax payments are growing much faster than the expenses they are supposed to support. Based on this disparity of money going in and that available to be spent, by the end of FY06, the projections are that the Education Fund will have a surplus of $137.6 million – $113.4 million more than it needs for a 5% "stabilization reserve." The annual operating surpluses of the Education Fund are growing substantially, projecting a slight deficit this year (FY03, due entirely to the state's rescission of $9.3 million in appropriations made to the Fund) to an annual extraction of $80.9 million in extra property taxes more than what will be spent by local schools in FY06.

If the state were to use this surplus to reduce the statewide property tax rate to achieve a balanced Education Fund, the statewide rates could look like this:

Year	FY2003	FY2004	FY2005	FY2006
Statewide Property Tax Rate Necessary	$1.10	$1.0553	$1.0071	$0.9646

The owner of a $100,000 property could see his or her statewide property tax bill reduced from $1,100 to $964.60, assuming no appreciation in value.

It is this inequity of revenues and expenses of the Education Fund, plus the downturn in General Fund tax revenues, that brings us to the verge of our dire warning – that the extra property taxes being collected would be used to reduce the state's General Fund support of education – becoming reality. This August, when faced with a large state General Fund deficit, the Joint Fiscal Committee reduced the amount of General Fund contributions to the Education Fund by $9.3 million. Last month, the Commissioner of Education notified school districts that "in light of the current state revenue picture" the administration is recommending that the mechanism to fund school spending above the block grant be adjusted to cost additional property tax payers higher rates.

The State General Fund had always been the sole source of the State's obligation to fund education and to try and equalize educational opportunity before Act 60. As the *Brigham* case proved, there was never enough to do the job. The funding level depended on the economic situation and the Legislature and administration's commitment to education as a priority. In the early days of Act 60, its proponents were committed to education and wanted Act 60 to work, so additional revenues were transferred. This not only assisted in the transition to Act 60 funding, but also provided property taxpayers the same opportunity for temporary tax relief as was afforded to income and sales tax payers when the Legislature reduced those tax rates in the economic boom time.

Now that times aren't so rosy, there is no talk of raising state General Fund taxes, but property taxes will be raised either now or later from what they could be by reducing General Fund support of education. The members of the Vermont League of Cities and Towns passed the following sections of their *2003 Municipal Policy* that encourage the Legislature and administration to restore the rescinded funds and keep General Fund support in line with other indices:

- The August, 2002 recission of $9.3 million of General Fund transfers destined for the Education Fund should be restored as soon as the General Fund revenues recover.
- Revenues arising from growth in the state grand list should not be used to fill gaps in the General Fund under any circumstances. Should the state grand list grow from one year to the next, either the education block grant should be increased, or the state property tax should be reduced, in direct proportion to the dollars generated by that growth.

Town officials can help to prove Carnac wrong by letting their legislative and gubernatorial candidates know that reducing General Fund support for education is the same as raising property taxes to pay for General Fund expenses, and that this is not acceptable.

- Steve Jeffrey, VLCT Executive Director (Steve notes that "Carnac the Magnificent" is most likely trademarked by Johnny Carson and/or the Tonight Show.)

VLCT News, October 2002