State of Vermont
Department of Taxes
133 State Street
Montpelier, VT 05633-1401

December 1, 2009

Rep. Shap Smith, Speaker of the House
Sen. Peter Shumlin, President Pro Tempore
Vermont State House
115 State St,
Montpelier, VT 05633-0004

Dear Speaker Smith and President Pro Tempore Shumlin:

It is my responsibility to report that the statewide property tax rate will increase this year absent reforms to our current system. Without such reform, the convergence of declining property values, a diminishing base of taxable property, and ever increasing school costs could result in a projected $0.22 rate increase over the next three years – a 26% rate increase in the residential tax rate.

There are many underlying factors for these difficulties, notably education spending increases and declining property values due to the recession. Growth in the grand list over the past ten years has fueled growth in revenue and spending in the Education Fund. The statewide equalized education grand list is calculated on a rolling three-year basis and, with the recession affecting the housing market, the statewide grand list will grow by only 2% for fiscal 2011 – less growth than in recent years. Starting in fiscal 2012, the equalized education grand list is predicted to drop in real terms for the next three years, putting extraordinary pressure on statewide and local property tax rates to support current and projected levels of education spending. *See Chart A.*

The decrease in property values is only one challenge affecting the property tax base. In recent years, there has been double digit growth in the Current Use program, *(See Chart B)* growth in Tax Increment Financing (TIF) Districts, more exempt properties and other expanding exemptions from the property tax. While these programs are important and worthwhile, each reduces the number of taxable properties or their taxable value, which diminishes the tax base and places more pressure on remaining property taxpayers. Further, continued growth in these programs raises equity questions that challenge the fundamentals of the Brigham decision.

School spending is expected to continue its uninterrupted growth despite dropping student enrollment and the strains of this recession. *See Chart C.* Vermont schools have a student-teacher ratio of 12:1 – one of the lowest in the country. At 92,000 students, we have 10,000 fewer students today than we did in 2000. *See Chart D.* Still school spending is projected to increase at 2% this year and for the next two years. Some 80% of this spending is personnel costs and it is common for existing teacher contracts to stipulate automatic salary increases of 3% a year even during this downturn. Other programs, such as Adult Education & Literacy and State-Placed Students, are also projecting increases.

Further, in the coming year Homestead Property Tax Adjustment (income sensitivity) payments will increase by $26 million – an 18% one-year increase. For fiscal 2012, this program is expected to grow another $14 million. From fiscal 2009 to fiscal 2012, the Homestead Property Tax Adjustments (income sensitivity) program is projected to increase a staggering 53%, from $119 million to $182 million. *See Chart E.*

A further complication of major proportions is the transfer from the General Fund to the Education Fund. Last session, the Legislature used one-time federal recovery funds to reduce the fiscal 2010 General Fund transfer and stipulated the transfer be level funded for fiscal 2011. However, in fiscal 2012, the transfer reverts to a statutory amount, based on inflationary growth, which will require a General Fund increase of $60 million above the current level. Since the Legislature's Joint Fiscal Office projects a cumulative three-year deficit of $384 million in the General Fund – exclusive of this $60 million increase – keeping this commitment to restore the transfer will be difficult, if not impossible. In fact, despite being the second largest contributor to the Education Fund behind the property tax, the General Fund will have no additional capacity to make up for declining property values, a shrinking tax base or increasing education costs.

As Commissioner of Taxes, it is my statutory duty as prescribed by 32 V.SA 5402(b) to recommend a tax increase to the General Assembly for the following fiscal year "*if there is a projected balance in the education fund budget stabilization reserve of less than three and one-half percent.*" Based on the current law, and after consulting with the required parties, both the Homestead and the Non-Residential tax rates will require a 2.2 cent increase for FY2011 under current law assumptions if the rates are increased equally. This means the Homestead (residential) rate would go from $0.86 to $0.882 and the Non-Homestead (non-residential) rate would go from $1.35 to $1.372 to meet the statutory obligations relative to the stabilization reserve fund.

Because of these unprecedented economic times and the extraordinary fiscal challenges in the Education Fund, I have asked for rate projections based on current law expectations but excluding an increase in the General Fund transfer through fiscal 2013. These projections are based on numbers provided by Deb Brighton, Tom Kavet, the Department of Education and the Department of Taxes, and assume a 2% growth in spending and the predicted decrease grand list values.

	FY2010	**FY2011**	**FY2012**	**FY2013**
Projected Increase	-	$0.022	$0.08	$0.120
Homestead Rate	$0.86	$0.882	$0.962	$1.082
Non-Homestead Rate	$1.35	$1.372	$1.452	$1.572

These projections show a three-year increase of 22.2 cents. A higher General Fund transfer would lower the rate increase, but as explained above, the General Fund has no capacity to support the Education Fund at levels needed to fully mitigate rate increases.

Since 2004, the Administration has presented the Legislature with numerous proposals to constrain the growth in education spending and protect property taxpayers while maintaining the quality education our children deserve. Unfortunately, most of these proposals were passed over or dismissed, which puts the state at a disadvantage to deal with the current challenges.

In their recent letter of November 10, 2009, Commissioners Vilaseca and Reardon proposed a number of possible options for constraining education fund spending to help protect property taxpayers. Further, I expect the Legislature's summer study committee to offer additional proposals to control spending in fiscal 2011. We look forward to working with the Legislature and the proposals generated by you and your colleagues.

Education funding is a fundamental state responsibility. Sustainability and equity are cornerstones of that system and when those fundamentals are in question, solutions and actions are expected. It will be necessary for all of us to engage the very difficult decisions before us with speed and determination, lest Vermonters be further burdened beyond the difficulties of the current recession.

Sincerely,

Richard A. Westman

Richard A. Westman
Commissioner of Taxes

Attachments:

A) Chart showing statewide grand list percentage change 2004 – 2012
B) Chart showing growth in current use FY2007 – FY2011
C) Chart showing spending growth vs. inflation 1981 – 2010
D) Chart showing student enrollment 1977 – 2024
E) Chart showing growth in income sensitivity FY2006 – FY2011