

# Vermont Legislative Joint Fiscal Office

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**Draft ISSUE BRIEF**

**Updated: April 9, 2020**

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## **Education Finance Issues Raised by the COVID-19 Pandemic**

### **Overview**

Vermont's education finance system is currently under unprecedented stress. Due to the loss of employment and business closures and as consumers rein in discretionary spending in response to COVID-19 stay-at-home directives, State revenues are expected to fall dramatically.

Consumption taxes dedicated to the Education Fund (EF) are now estimated to fall by \$88.7 million below the consensus forecast for FY2020 published in January.

Going into the COVID-19 pandemic, the EF was in good fiscal condition with a full \$36.4 million stabilization reserve and an estimated \$12.9 million surplus. However, after accounting for the COVID-19 related loss of consumption taxes, those reserves are not sufficient to fully cover EF spending in the current fiscal year. The EF is now projected to close FY2020 with a \$39.5 million deficit. Moreover, if \$53.5 million in deferred consumption taxes are not fully remitted to the State at the end of June, this fund deficit could grow even larger.

In FY2021, COVID-19 related loss of consumption tax revenues is expected to be even more severe. In addition, the collection of property tax revenues is uncertain because many property taxpayers may be unable to make timely payments. However, at this point in time no estimates of revenues in FY2021 exist. Evolving epidemiological models, which will shed light on the depth and duration of the economic slowdown, should make it possible to develop reliable revenue projections; however, these projections may not be available for some time.

Voters have already approved a \$73 million increase in education spending in FY2021. Even if it were possible to reduce education spending next year, those efforts could be constrained by existing teachers' contracts since salaries and benefits alone account for nearly 80% of education spending. As of today, however, most contract negotiations between school boards and teachers for FY2021 remain open over salaries and employee benefits other than health insurance.

The only way to significantly reduce spending in FY2021 once teachers' contracts are place for the school year would be to layoff teachers and other staff – a measure now largely precluded for FY2021 since deadlines for reduction-in-force notices to teachers have already passed or will pass soon. In any case, laying off teachers and staff would not be a desirable outcome in the midst of an economic downturn.

Normally, the Legislature sets education property tax parameters – including the yields and the nonhomestead property tax rate – prior to adjournment for the upcoming fiscal year. However, given the level of uncertainty about the fiscal condition of the EF at the end of FY2020 and the magnitude of any revenue shortfall in FY2021, setting education property tax parameters for

next year will be difficult. There are default education property tax parameters set forth in current law, but they are not ideal.

One bright spot is the federal stimulus bill passed on April 27<sup>th</sup>. Vermont's allocation of the \$30.7 billion for the Elementary and Secondary Education Emergency Relief Fund is \$31 million. Under the Federal bill, 90% of these funds or about \$27.1 million will be paid directly to Supervisory Unions and bypass the EF entirely. The remainder may be retained by the Administration for COVID-19 related emergency needs. Vermont was also allocated another \$4.5 million in discretionary aid from the Governor's Emergency Education Relief Fund.

Other issues discussed below include: (1) potential cash flow concerns in FY2020; (2) scheduling of votes or re-votes on school budgets that have not yet passed or adopting default budgets; (3) the impact of moving the personal income tax filing to July 15<sup>th</sup> for the homestead declaration and the property tax credit claim; (4) and the property tax credit for taxpayers, which will not provide additional assistance for taxpayers who experience significant COVID-19 related loss of household income in 2020.

### Summary

- Non-property tax revenues dedicated to the EF in FY2020 are now expected to fall \$88.7 million below the January forecast. Municipalities have already collected most of the education property taxes due in FY2020; however, as of April 1<sup>st</sup>, 82 municipalities still have an estimated \$132 million outstanding.
- Businesses will be allowed to defer transfer of \$53.9 million in trustee taxes due in April and May to June 25<sup>th</sup>. This deferral includes the sales and use tax and the meals and use tax. Even if this revenue is fully remitted to the State by the end of this fiscal year, this deferral may create an EF cash flow problem in FY2020.
- School districts receive three payments from the EF. The last payment, due on April 30<sup>th</sup>, is still outstanding. Since budgets are set, school districts will need to reallocate existing funds, use reserves, or run deficits to cover the cost of any additional COVID-19 related spending in the 2019-2020 school year.
- The EF will run a significant operating deficit in FY2020. Moreover, the projected \$12.9 surplus and the \$36.4 million stabilization reserve will be fully depleted by the COVID-19 related loss of consumption taxes leaving a \$39.5 million deficit which could grow larger if deferred consumption taxes are not remitted in full.
- Vermont will receive \$30.1 million through the federal elementary and secondary education emergency relief fund. However, these funds are paid directly to Supervisory Unions by-passing the EF. Another \$4.5 million in discretionary assistance for education-related agencies, is also available.
- Setting the education tax rate parameters – the property yield, the income yield, and the nonhomestead tax rate – for FY2021 prior to adjournment will be problematic given the current level of uncertainty. However, there are default education tax rate parameters set forth in current law.

- COVID-19 related EF revenue losses are expected to be significantly higher in FY2021 for both education (and municipal) property taxes and non-property taxes due to the COVID-19 related recession. Reliable estimates are not yet available, however, and may not become available for several weeks.
- Voters have already approved 94 school budgets that will increase education spending by \$73 million over FY2020 levels in FY2021. Voters defeated nine school budgets in March and other school districts have votes scheduled in April or May. How and when these votes will take place now is uncertain.
- The property tax credit for FY2021 will be based on CY2019 income, so there will be no property tax assistance for taxpayers who experience COVID-19 related loss of income in 2020. There may be a surge in property tax claims in FY2022; however, household income is defined broadly to include unemployment insurance and other assistance.
- Moving the filing deadline for the property tax credit to July 15<sup>th</sup> creates a potential problem for municipalities to issue timely education property tax bills in FY2021. However, the tax department does not expect this to be a significant problem as municipalities may delay billing until after August 1<sup>st</sup> when information on property tax claim is available.

#### **COVID-19 Related Loss of Education Fund Revenue FY2020**

In the January revenue forecast, total EF sources were estimated to be nearly \$1,711 million. Of this amount, education property taxes accounted for \$1,140 million or roughly two-thirds of total EF revenue. Non-property revenue, primarily consumption taxes, accounted for the remaining \$571 million, or roughly one-third of total EF revenue.

Most of the education property taxes due for the current fiscal year have already been collected by municipalities. However, each municipality has its own billing schedule and at present many municipalities still have outstanding tax payments due. How much of these outstanding taxes will not be paid in a timely fashion due to COVID-19 related layoffs or business losses is uncertain.

*Updated 4/1*

Number of Payments	Number of Towns	Net Education Property Taxes Collected (\$M)	Towns with Payments Due	Net Education Property Taxes Due (\$M)
1	120	\$311	0	\$0
2	70	\$260	25	\$34
3	20	\$197	8	\$16
4	49	\$244	49	\$81
<b>Total</b>	<b>259</b>	<b>\$1,011</b>	<b>82</b>	<b>\$132</b>
<i>Percent of Total</i>	-	88%	-	12%

As indicated in this table, there are currently 82 municipalities that have \$132 million in outstanding education property tax collections for FY2020 as of March 15<sup>th</sup>. The statewide cost of failure to collect one-percent of these outstanding property taxes would be only \$1.32 million. However, there are 25 municipalities that have not yet collected one-half of their total education property tax collections.

Non-property tax revenues from the sale and use, purchase and use, and meals and rooms taxes were estimated to raise almost \$528 million in FY2020. Total revenues from these three non-property taxes are now expected to fall \$88.7 million below the January revenue forecast as the economy slows due to layoffs and business losses and consumers rein in their discretionary spending. This loss represents more than 5.2% of total EF revenues in FY2020.

In addition, the Administration will allow businesses to defer payment of the sales and use tax and the meals and rooms taxes due in April and May to June 25<sup>th</sup>. If businesses are able to remit the total amount of outstanding tax due on June 25<sup>th</sup>, this will not result in an additional revenue downgrade for FY2020; however, collection of the full amount due after deferral is not a certainty. Even if remitted in full, this trustee tax deferral may create a cash flow issue for the EF in the current fiscal year.

### **COVID19-Related Spending by School Districts in FY2020**

In response to the COVID-19 pandemic, the Governor ordered the dismissal of all schools and the cancellation of all school-related activities through April 6<sup>th</sup>. During this period of dismissal, school employees are directed to report to work or to work remotely and school districts have been directed to continue to pay all school staff, including hourly employees, and to continue to make prekindergarten tuition payments to private providers.

Although guidance from the Agency of Education (AOE) indicates that during the initial dismissal period, regular educational services do not continue and students are not expected to make educational progress, other services will continue to be supported by school employees including:

- District-based options for childcare for “essential” employees encouraged
- Meals services for those who need it
- Creating a plan for continuing services for students with disabilities and special needs
- Systems for ensuring the maintenance of education for students
- Cleaning and disinfecting school grounds

The additional cost associated with the provision of these services may not be large. School districts remain eligible for certain Federal and State reimbursements for school meals and the Administration has indicated that school districts that require supplemental funding for child care services provided to essential workers will also be reimbursed, although the source and amount of this funding is uncertain.

Since it has now become necessary to extend closure period beyond April 6<sup>th</sup>, school districts will be asked to provide more formal education services to students for the remainder of the school year. Schools will be required to create Continuing Education Plans for all students and

all educational services, to the extent possible, must be offered to students through various remote and virtual means.

Since school budgets are set, any additional funding required to provide educational services during the 2019-2020 school year will require school districts to reallocate existing funds, use reserve funds, if available, or run a deficit that would carryforward into the next school year. However, this far into the current school year school districts have less flexibility to reallocate funds and districts are universally thin on reserves.

### **Cash Flow Issues in FY2020**

Prior to the COVID-19 outbreak, the EF was projected to close FY2020 with a full stabilization reserve of \$36.4 million and a surplus of \$12.9 million. However, with the COVID-19 related loss of consumption taxes dedicated to the EF, without additional funding from some other source, the EF will run a significant operating deficit in FY2020.

Under current law, school districts receive three payments from the EF on September 10<sup>th</sup>, December 10<sup>th</sup>, and April 30<sup>th</sup>. For school year 2019-2020, the April 30<sup>th</sup> payment to school districts is still outstanding. This payment includes state categorical aid for special education, transportation, and small schools as well as the education payment. Revenue losses and deferral of some trustee taxes could create a cash flow issue for the EF.

Municipalities must be timely in their payments of statewide education property tax to the State even if property taxpayers are delinquent or fail to pay their taxes. Consequently, in addition to losing municipal property tax revenue, municipalities would need to remit the full amount of education property tax owed to the State. There is also an 8% penalty for late payments, but the Commissioner of Taxes likely can exercise his general authority to waive the penalty.

### **Federal COVID-19 Stimulus Bill**

The Federal COVID-19 stimulus bill includes \$13.2 billion for formula grants to states. Vermont's allocation is \$31 million. States must distribute 90% of their allocation to Supervisory Unions based on their proportional allocation of Elementary and Secondary Education Act Title I-A funds. Up to 10% of the allocation may be retained by AOE for emergency needs and administrative costs.

Funds distributed to Supervisory Unions may be used for COVID-19 response activities, such as planning for and coordinating during long-term school closures; purchasing educational technology to support online learning; and additional activities authorized by federal elementary and secondary education laws.

The federal legislation provides that the State shall award this aid as subgrants to Supervisory Unions. Federal aid to elementary and secondary schools distributed this way would bypass the EF. If the allocation to Supervisory Unions was made after June 30<sup>th</sup>, the payments would be treated as "offsetting" revenues in FY2021 and be subtracted from school budgets to arrive at education spending for the purpose of setting education tax rates.

An additional \$4.5 million in discretionary assistance is available through the Governor's Emergency Education Relief Fund. However, these funds are also available for institutions of higher education and other education-related agencies and may be used for the provision of child care and early childhood education, social and emotional support, and the protection of education-related jobs.

### **Setting Education Tax Rates for FY2021**

Prior to adjournment, the Legislature normally sets the property tax parameters for the upcoming fiscal year including the property yield, the income yield, and the nonhomestead property tax rate. Given the current level of uncertainty about the health of the EF at the close of FY2020 and the magnitude of a likely FY2021 revenue shortfall, setting education property tax parameters for FY2021 will be problematic.

COVID-19 related revenue losses are expected to be significantly higher in FY2021 than they are in FY2020. At this point in time reliable estimates of how significant those revenue losses will be are not available. The Legislative economist is currently assessing likely FY2021 revenue impacts in the light of evolving epidemiological models; however, it is not clear given current uncertainties when reliable revenue estimates will be available for FY2021.

Voter-approved EF spending for FY2021 is \$73 million higher than in FY2020. In March voters approved 94 school district budgets that increased education spending by \$62 million over FY2020 levels. Other EF spending for State categorical aid as well as other uses is estimated to be up another \$11 million over FY2020 levels. Note that any reduction in State categorical aid for special education, transportation, or small schools will increase education spending by the same amount.

Even if it is possible to undue voter-approved education spending, efforts by districts to reduce budgeted education spending in FY2021 may be constrained by teacher contracts since salaries and benefits alone account for almost 80% of education spending statewide. However, as of today, negotiations between teachers and school boards for FY2021 contracts remain open in most school districts.

In districts with contracts in place for FY2021, the only way to significantly reduced spending would be to lay off teachers and other staff – an undesirable outcome if the midst of an economic downturn. At this point, this option may be largely precluded since the deadline for reduction-in-force notices in most school districts has passed or will soon pass.

In March voters defeated nine school district budgets and in five school districts the vote is scheduled in April or May. When the municipalities that belong to these districts will be able to vote on their school budget is uncertain. Note that if voters are unable to pass a school budget by June 30<sup>th</sup> there is a default in current law that will allow a school district to continue to operate by borrowing funds necessary to enable it to operate on a budget up to 87% of the most recently approved budget. Other options are currently under consideration.

In addition, an interim homestead education tax shall be imposed at the base rate or \$1.00 divided by the municipality's most recent common level of appraisal, but without regard to any spending adjustment. Within 30 days after a budget is adopted and the deadline for reconsideration has passed, the Commissioner of Taxes determines the municipality's homestead tax rate.

If the yields and nonhomestead tax rate are not set prior to adjournment, there are default parameters set forth in current law. The property and income yields would remain at their FY2020 level and the nonhomestead tax rate would remain at its statutory level of \$1.59. Alternatively, these tax rate parameters could be set as recommended by the Commissioner of Taxes last December. Board-approved school budgets were presumably presented to voters with the spending-adjusted homestead tax rates that result from these parameters in mind.

The following table compares net homestead and the nonhomestead property taxes under the December 1<sup>st</sup> and the default education property rate parameters in FY2021. Each option raises a different amount of tax revenue and the impact on homestead and nonhomestead property taxes varies between classes of property taxpayer. Under both options, education taxes go up for both classes of taxpayers compared to FY2020.

	<b>FY2020</b>	<b>FY2021 – December</b>	<b>FY2021 – Defaults</b>
Property Yield	\$10,648	\$10,883	\$10,648
Income Yield	\$13,081	\$13,396	\$13,081
Uniform Nonhomestead Tax Rate	\$1.594	\$1.654	\$1.590
Average Homestead Tax Rate	\$1.510	\$1.558	\$1.593
Average Income Tax Rate	2.47%	2.55%	2.60%
<b>Estimated Revenue (\$M)</b>	<b>\$1,140</b>	<b>\$1,220</b>	<b>\$1,206</b>
Net Homestead Taxes	\$447	\$476	\$490
Nonhomestead Taxes	\$694	\$744	\$716

Note that the legislature is free to set education property tax parameters as it sees fit. These are two obvious possibilities, but there are many others.

### **Other Issues**

#### *No Property Tax Credit for COVID-19 Related Loss of Income in 2019*

The property tax credit for FY2021 (fall 2020) will be based on CY2019 household income filed in April through July. Consequently, there will no COVID-19 related property tax assistance to assist taxpayers who lose household income due to layoffs or business losses until FY2022 (fall 2021). In FY2022 (fall 2021), the property tax credit may increase; however, household income is defined broadly to include unemployment compensation and other assistance. All taxpayers will receive their normal property tax credit based on their 1999 household income.

*Moving the Tax Filing Deadline to July 15<sup>th</sup>*

Under current law, the filing deadline for both the homestead declaration and the property tax credit claim is April 15<sup>th</sup>. The Commissioner of Taxes has now pushed that deadline back to July 15<sup>th</sup> to conform with the personal income tax filing deadline. This creates a potential problem for municipalities to issue timely net education property tax bills in FY2021.

The tax department has testified that this delay is manageable since under current law municipalities may delay issuing property tax bills until August 1<sup>st</sup> when the tax department will have homestead declarations and property tax credit claims processed. Alternatively, municipalities may issue property tax bills on their normal timeline and later issue corrected tax bills. Municipalities would have to balance cash flow with the cost of sending corrected tax bills.