Pennsylvania Association of School Business Officials

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Testimony of Jay Himes, Executive Director
PA Association of School Business Officials
House Select Committee on Property Tax
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Good morning. I am Jay Himes, executive director of the PA Association of School Business Officials (PASBO). We are a statewide organization of school employees other than superintendents and teachers who are responsible for management of finance and operations in schools that support classroom learning. PASBO members lead and manage accounting, budgeting, facilities, food service, human resources, purchasing, safety, technology, transportation and communications services for local education agencies in Pennsylvania.

I want to thank Chairman Quigley and Vice Chairman Briggs as well as all other members of the Select Committee on Property Tax for the opportunity to discuss the vexing issue of school finance and specifically school property taxes. We not only appreciate this opportunity but will assist the committee in the continuing effort to fashion changes in state policy that will help schools, students and taxpayers. But it is not an easy job. The pursuit of local tax restructuring that reduces the burden of the property tax and adequately funding schools go hand in hand but are often at odds—and have been for decades.

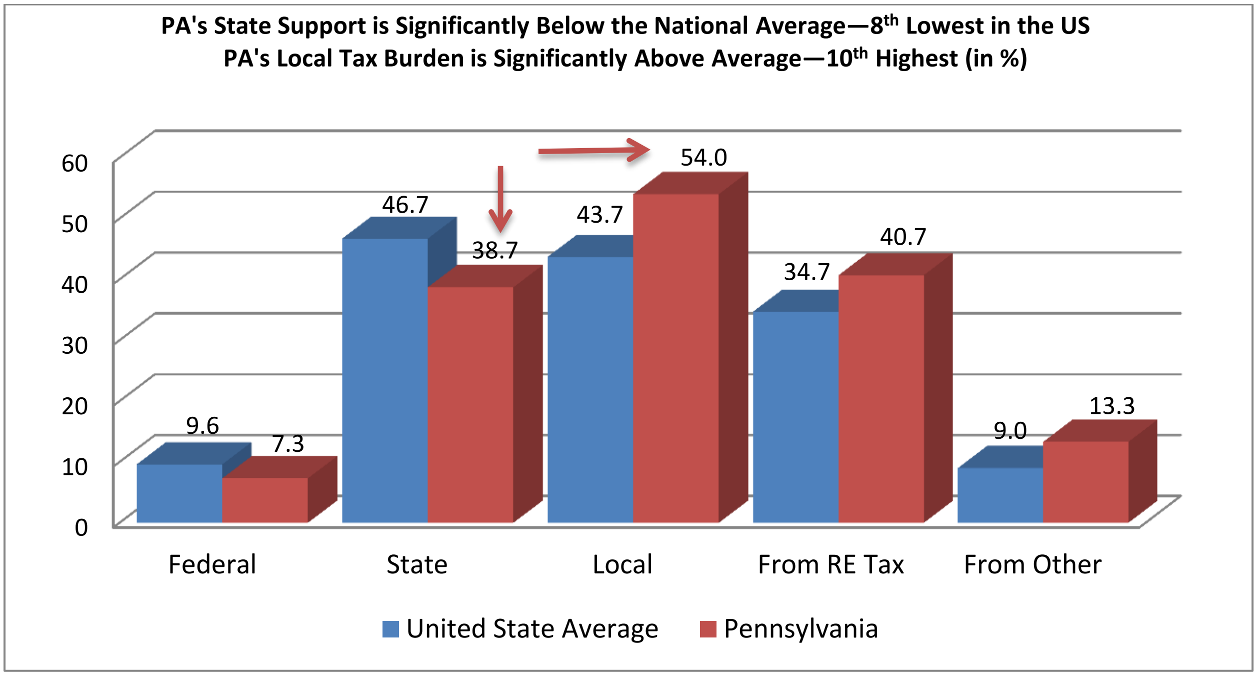
There are three goals in what seems like an endless pursuit of "reform" of education funding and the local tax structure:

1. Provide adequate and equitable resources to schools that allows for student success.
2. Define the fiscal partnership between state government and school districts to determine who pays how much of the cost of education
3. Determine the proper tax mix that provides the necessary resources while also assuring taxpayers of fairness and efficiency.

These are major and difficult policy discussions. In terms of the first two issues, we duck a comprehensive and comprehensible state policy by an annual budget allocation process. In terms of funding sources, we have been stuck in a 1960's tax structure that is limping along relatively untouched for the past 50 years. With three 800 pound gorillas in an overcrowded room it is hard to move one much less three in any direction. The result is status quo. While there may be a lot of disagreement and dissatisfaction in all three areas by state policy makers, schools and the public, the only consensus appears to be that no one likes the status quo.

On the question of funding sources at the state and local level, let's take a quick look at school finance in PA and how it compares with surrounding states.

As the chart below indicates we have placed significant revenue responsibilities at the local level which help to assure decision-makers can address local needs with local resources.



We continue to use local revenues to fund more than half of the cost of public education. For the 2008-09 fiscal year, according to US Department of Education Data, we ranked 10th highest of all states in the percent of total revenue from local sources. This reliance on local taxes also means our reliance of state revenues is well below average at 38.7%--8th lowest in the country.

These sources are the major contributors to school budgets. In PA, federal revenue accounts for 7.3% of total revenues with most of that funding targeted to poorer districts. There is also a cause and effect—generally the more reliance on state funding the lower the local burden which means less onerous property taxes.

Since schools have limited options in local taxes, we have a high reliance on the property tax to fund schools. For the 2010-11 fiscal year, of the nearly $13.5 billion in total local revenues, 83% was property tax with the Local Earned Income Tax generating 12% and other tax sources combined making up the remaining 5%.

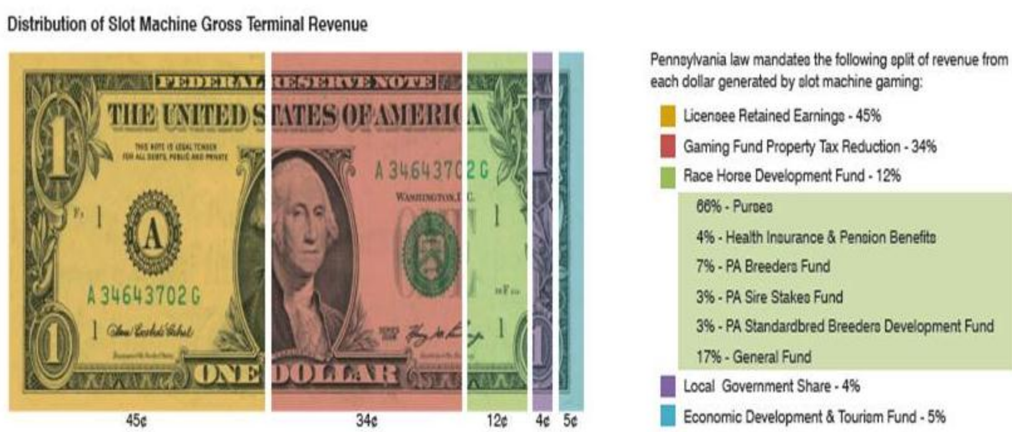
To reduce the burden of the property tax there are any number of measures that could be taken:

1. *Provide additional tax capacity (other than real estate) at the local level to balance out property taxes with income or other taxes.* The General Assembly passed and the Governor signed such a plan in 2006 but voters in only 8 of 501 school districts thought it was a good idea and approved the tax trade by referendum. Perhaps times and voter sentiment has changed—perhaps not. While additional EIT capacity could help reduce the property tax burden it would shift taxes with retirees benefitting generally and working families footing more taxes.

There is also a blue collar bias to the EIT since workers get taxed and wealth doesn't. Perhaps more ambitiously, the residential property tax could be replaced by a <u>local</u> Personal Income Tax while keeping the real estate tax for commercial and industrial properties. Implementation of this idea would require the more difficult process of amending the state Constitution.

Keeping a PIT replacement for property taxes as a locally levied and collected tax would diminish many of our concerns with retaining local discretion, predictability and stability in school resources and minimizing transitional issues. Moreover keeping a local income tax in place would not waste millions of dollars invested in moving the school and municipal income tax collection process to a county wide basis under Act 32 of 2008.

2. *<u>Increase state funding that would reduce the local burden and as a result property taxes.</u>* Clearly we understand and appreciate that there is no new state revenue but there could be other shifting of funds from existing programs. For example the gaming fund has been providing about $600 million in annual property tax reduction through the homestead/farmstead exclusions that appear on school district property tax bills. But the Gaming Fund is generating much more than the amount that goes just to the Property Tax Relief Fund as indicated in the chart below. Specifically, we suggest that using economic development funds for a targeted senior citizen and/or means tested homestead/farmstead relief would help the lower the residential tax burden for property owners. For 2011-12 about $124 million was generated in gaming taxes for this purpose.



3. *<u>Reduce or eliminate state mandates with savings dedicated to generate property tax reductions.</u>* While I am sure members of the General Assembly hear the mandate refrain often, it is no doubt a significant contributor to our property tax dilemma. Indirectly, curtailing the expenditures for mandates such as retirement funding, special education, charter and cyber charter tuition, non-public transportation, Prevailing Wage Law, property tax collection, etc. would allow for diminishing the property tax burden.

4. *<u>Fully evaluate the impact Act 1 has had and will have on property taxes.</u>* Act 1 was designed to establish a ceiling on property tax increases and I believe it has accomplished that objective. Originally, the Act 1 Index as indicated below was near or above 4%. However due to economic circumstances the Index is now trending downward at its lowest point since the enactment of the law. We do not know what the effect of the reduction of the index will be on property taxes for 2011-12 and 2012-13 since we do not have the data from school district Annual Financial Report.

   However, we can conclude that property tax revenues should be down in comparison to previous years based on the reduction in the Index and with the enactment of even further restrictions on exceptions to the Index in Act 25 of last year. <u>Prior to Act 1, for 2000-01 to 2005-06 total school expenditures statewide increased by 32.7% and total property taxes increased by 36.0%. If we take the same time period after Act 1, we see total expenditure increases of 19.6% and 15.0%, respectively.</u> While there are other factors, there does seem to be a downward trend of increases in total expenditures and property taxes as seen in the table below in tandem with the reduction in the Act 1 Index.

	2010-11	2009-10	2008-09	2007-08	2006-07	Prev. 5 Yr. Avg.
Total School Expenditures	2.3%	3.5%	2.5%	5.1%	4.7%	5.8%
Property Taxes	3.5%	3.1%	-0.3%	4.6%	5.9%	6.3%
Act 1 Base Index Change	2.9%	4.1%	4.4%	3.4%	3.9%	NA

   Obviously, there have been other significant factors that prevent a direct correlation from this data, but we believe Act 1 has moderated property tax increases. I would expect future data to support the decline in the growth rate of property taxes in the past two fiscal years even with the huge financial mandate for pension funding.

We believe these ideas could form the base of policy changes that would have a beneficial impact on property taxes for taxpayers AND schools. However, we believe the drastic and devastating move to completely eliminate property taxes will create a whole host of related problems that makes this approach unworkable from a school finance perspective.

Here are the problems we see:

1. At the core of any shortcomings of property tax elimination is the <u>huge tax shift</u> that occurs. If property taxes are eliminated then non-residential properties receive a huge windfall. Business and corporate taxpayers will receive a huge reduction in property taxes that will be offset by significant personal tax increases via the state's Personal Income Tax and Sales Tax.

By calling for property tax elimination some residential property owners will likely be calling for an increase in their taxes regardless if they are state or locally levied.

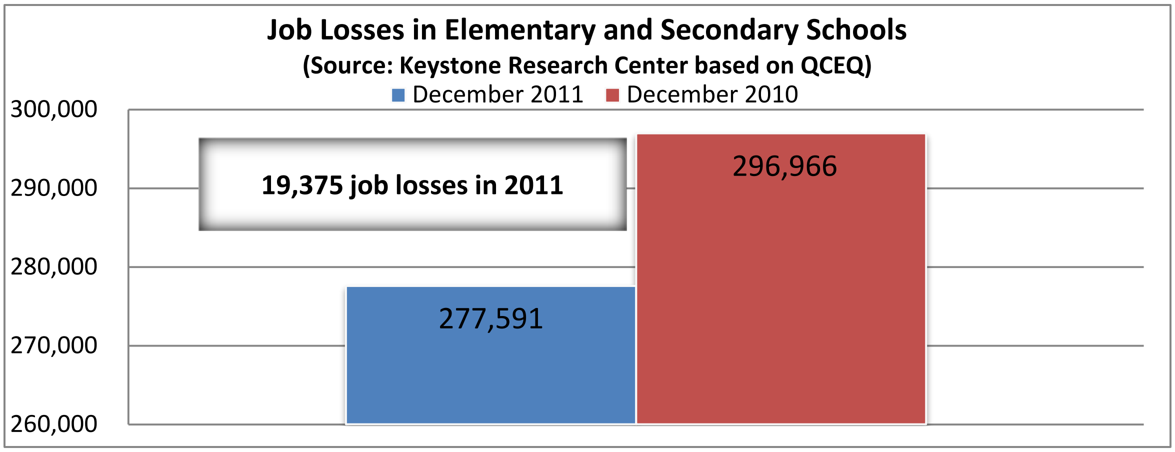
2. Almost as critical is the need to detail how any additional state replacement revenue would be distributed. It is an extraordinary leap of faith to set forth a goal of replacing more than $11 billion in school revenues with unspecified redistribution by state taxes. Not only would schools object to the lack of a distribution plan, taxpayers should also object to a plan that sends significant new revenue to Harrisburg with no knowledge about how it comes back to their school district.
3. Less reliance on local taxes does provide a broader base for collecting revenues devoted to education. However, rating agencies like local authority for levying taxes in determining school district credit ratings. As a result the cost of borrowing will likely increase but to what extent is unknown.
4. School budgeting will become chaotic as school funding is determined year to year in a last minute fashion as the state budget is finalized. Now more than ever schools need predictability in crafting more complex school budgets. Cash flow needs alone will send many districts into emergency borrowing if simultaneously front-end local revenues from property taxes are replaced with evenly distributed state revenues.
5. Schools need stability to continue to balance growing expenditures and reduced state resources. The ability to have a long term financial plan with a front-ended revenue stream that assures revenues at the beginning of the fiscal year disappears if the property taxes are eliminated or severely reduced. With districts spending fund balance at alarmingly levels, there will be no financial buffer to allow for this drastic change in cash flow.
6. Perhaps in the big picture the most important policy question is whether the General Assembly wants to sustain local control by school boards or whether the state will become the education provider. Removing locally generated revenue moves the focus of education from being locally delivered and administered to a state function. If local resource capacity is removed, state control of finances will mean state control of education.

Keeping the property tax in place to support stability, predictability and local control while at the same time reducing the burden on residential property tax payers in particular would be a policy direction we could support. Fairness in the property tax could be improved if we addressed the lack of up to date assessments. Keeping assessed values current would not only promote fairness but it would also help to reduce assessment appeals that provide significant reductions to commercial and other business properties at times when school and municipalities are most in need of revenue.

Another improvement in property tax administration would be to modernize the tax collection system. There really is not a "system" in place. We have an archaic and inefficient property tax collection process. We could apply greater technology investments that would produce savings in collection and additional investment income if the outdated statutory requirements were removed and schools could collect their own real estate taxes or mimic the county wide process for EIT under Act 32. Recently the PA Supreme Court told two districts in Bucks County that their efforts to provide efficiencies in real estate tax collection were invalid in part because the reduction in compensation to tax collectors did not consider time spent on "customer service." We don't have elected tax collectors for state taxes or for the local EIT; why do we need them for real estate taxes? We could also help current property tax collection by giving the schools the option to choose between delinquent tax collection under the Real

Estate Tax Sale Law or the Municipal Claim and Tax Lien Law as proposed in House Bill 1877 which we support. This bill could save schools and taxpayers millions in property tax revenue.

Schools are in a historic transition. There have been unprecedented efforts to reduce costs in the face of historical increases in mandated pension costs. As indicated below personnel have been reduced by almost 10% in 2011.



Job losses have translated to reductions in salaries and benefits, contracting out various non-instructional services such as food service and transportation, larger class rooms and in some cases building closures. There have been wage freezes as well which haven't occurred for decades, if ever. In addition, new revenues have been raised by imposing extra-curricular fees on students. Schools have been able to survive during this of financial distress (and a crisis for some districts) through a series of difficult decisions to reduce expenditures but also by prudent financial planning. Removing local taxing authority reduces the capacity to plan and to allow local decisions on how best to meet local priorities.

Nobody likes taxes except taxes somebody else pays. Schools do not have significant tax options. Creating a new mix can keep local decision making and stability in place and at the same time reduce the property tax burden. Reducing the costs to schools through mandate relief would also help to reduce the tax burden regardless of the tax levied. Finally, having the state as an equal partner would also help to reduce the property tax burden.

Thank you again for the opportunity to present our views on this important issue. I will be glad to respond to any questions you may have.

ABOUT PASBO

www.pasbo.org

Smart Business + Informed Decisions = Great Schools

The Pennsylvania Association of School Business Officials (PASBO) is a statewide association, 3,000 members strong, devoted to helping the business of schools stay on the right track through education, training, professional development and timely access to legislative and policy news. Our membership base covers school professionals working in finance, accounting, operations, facilities, transportation, food service, technology, communications, human resources, purchasing and safety services. While diverse in areas of specialty, all members share a common goal - to support classroom learning in schools during good and bad economic times through smart business practices. PASBO helps make that goal a reality.