



The Importance of the Act 1 Exceptions

Act 1 has played an important role in slowing property tax growth since 2006, limiting the growth to the Act 1 index, a factor calculated based on the annual increase in the statewide average weekly wage for the prior year, the increase in the Employment Cost Index for Elementary and Secondary Schools for the prior year and a school district’s local wealth. The Act 1 index is calculated each year by the PA Department of Education (PDE).

In addition to the Act 1 index, Act 1 of 2006 recognized that there were certain costs and situations in which a school district may need to increase property taxes above the Act 1 index. For this limited list of specific situations, which included electoral debt, special education expenditures and pension expenditures, school districts could apply to PDE for approval to raise property taxes above the index.

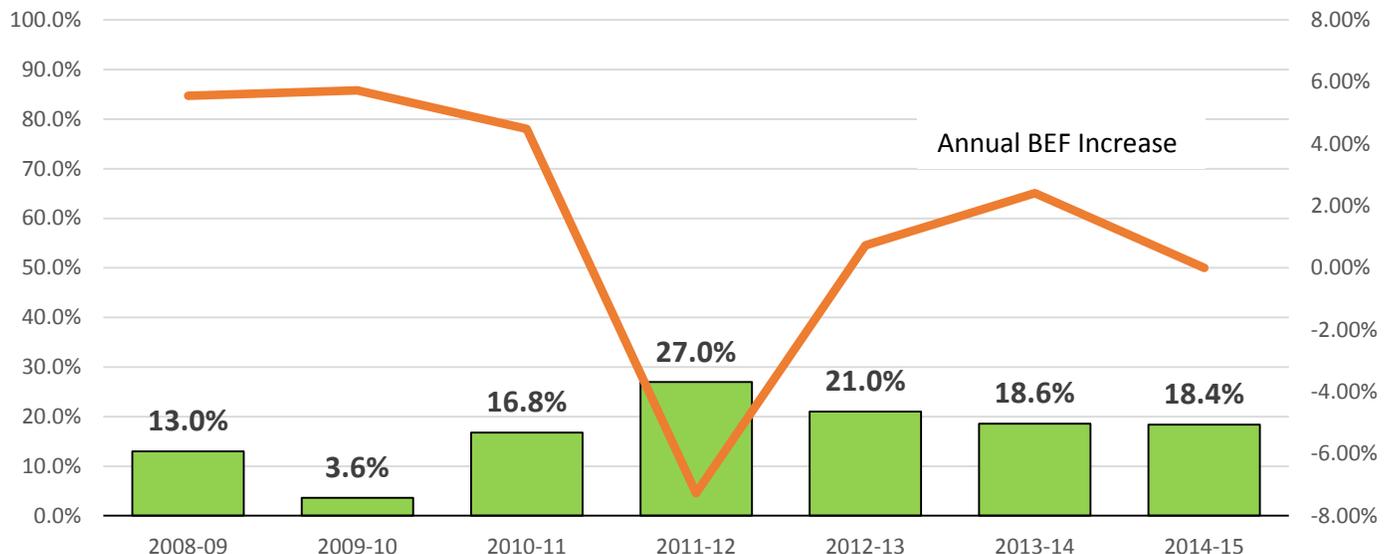
In 2011, the vast majority of these Act 1 exceptions were eliminated, leaving only exceptions for pension and special education expenditures, as well as the exception for electoral debt. Additionally, the grandfathered debt exception was preserved as well for a limited number of districts.

How School Districts Use Act 1 Exceptions

Act 1 exceptions are critical for school districts, and since the inception of Act 1 in 2006, many school districts have applied for and have used an exception to increase property taxes above the Act 1 index to help cover increases in some of their fastest growing mandated expenditures.

But, while many school districts have used Act 1 exceptions at some point since 2007-08, it is important to recognize that each year only a small percentage of school districts actually use Act 1 exceptions to increase property taxes above the index. Out of 500 school districts, only a minority use these exceptions each year, and the total number of school districts using these exceptions has been falling each year since 2011-12. Overall, the number of districts using Act 1 exceptions decreases as basic education funding line item increases. See the graph below indicating the percentage of school districts that have used Act 1 exceptions each year compared to basic education funding line item increases.

Percentage of Districts Using Exceptions vs. BEF Increases

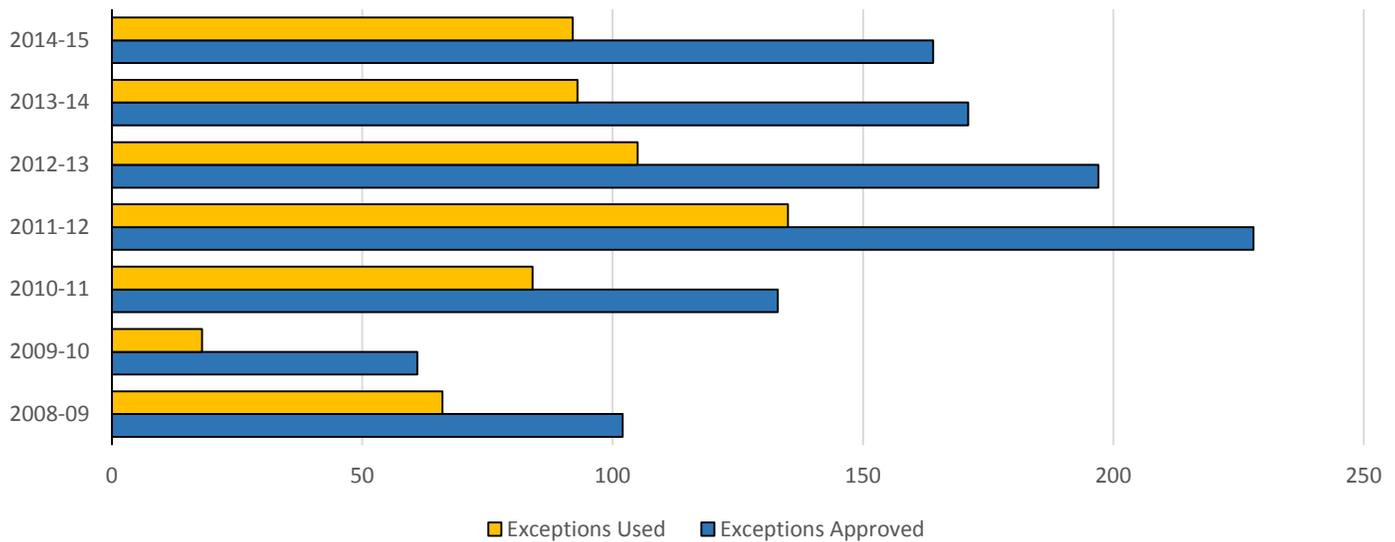


SOURCE: Prepared by PASBO using PDE reports on Act 1 exceptions and PDE historical subsidy data.

Since only a small percentage of school districts actually use Act 1 exceptions each year, why do so many school districts apply for these exceptions? School district budgeting is a complex exercise that begins each fall and involves some guesswork due to the fact that a school district does not know what revenue it will receive from the state until the end of June—or sometimes much, much later. Preparing a budget in the absence of any concrete information about the amount of state education funding makes it necessary for school districts to ensure that they have all options on the table. As a result, many school districts pass a preliminary budget at the end of January and apply for Act 1 exceptions by the mid-February deadline.

In many cases, school districts that are being conservative about their revenue projections end up not needing to use their approved exceptions. In fact, in most years, just over half of the districts that have applied for and received Act 1 exceptions actually use them. See the graph below highlighting how many school districts actually used the Act 1 exceptions for which they have been approved.

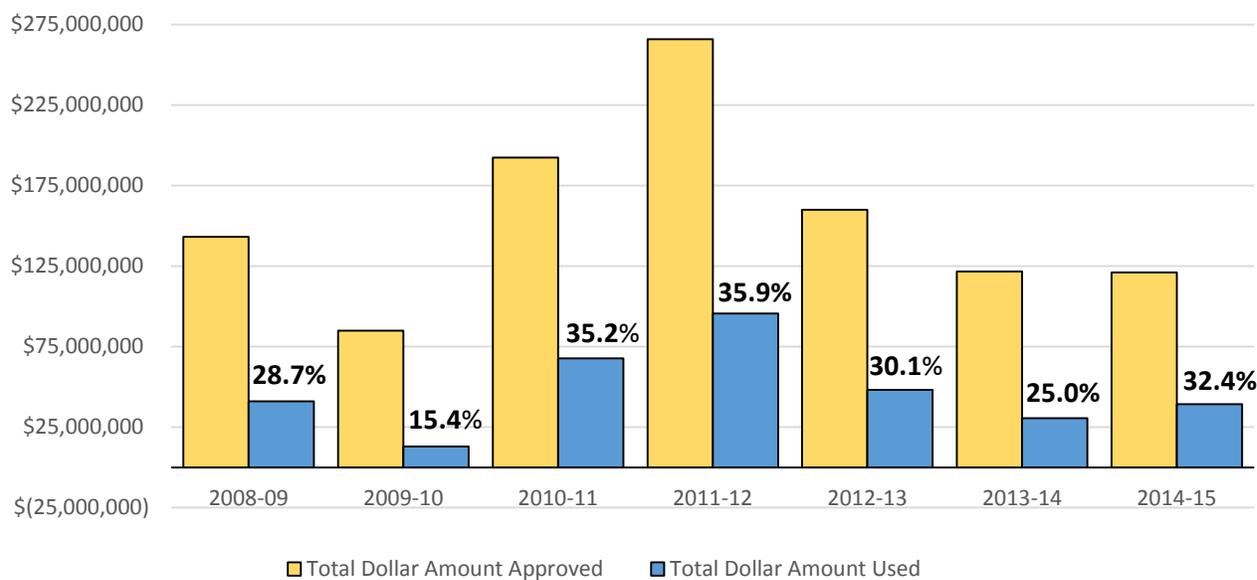
Act 1 Exceptions Approved vs. Used by Number of Districts



SOURCE: Prepared by PASBO using PDE reports on Act 1 exceptions.

Additionally, it is important to understand that while, generally, just over half of the districts that apply for and receive Act 1 exceptions actually end up using them, a much smaller percentage of the approved total local property tax increases have actually been implemented. On average, only about a third of the total property tax increase due to approved Act 1 exceptions is implemented in any given year, and the vast majority of the approved tax increase is never used. See the graph below, illustrating the percentage of total dollars due to approved Act 1 exception increases that are actually implemented each year.

Total Amount of Act 1 Exceptions Approved vs. Used



SOURCE: Prepared by PASBO using PDE reports on Act 1 exceptions.

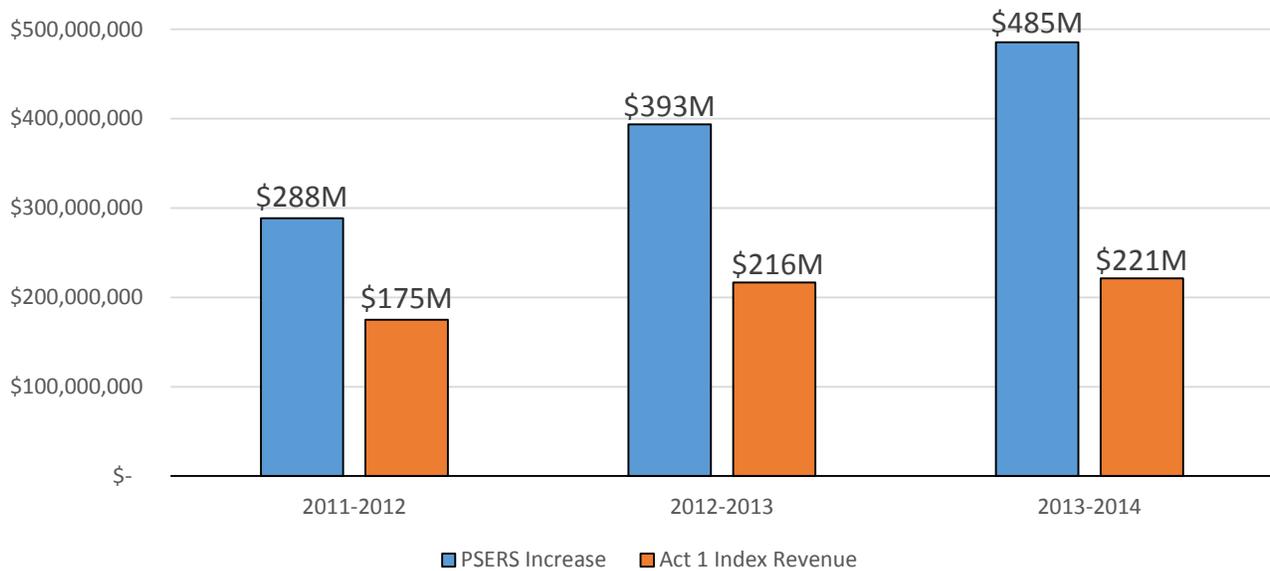
Why Do School Districts Need Act 1 Exceptions?

While the pension and special education exceptions have not always been the most frequently used exceptions, after years of rising employer pension contribution rates, flat special education funding and the elimination of the vast majority of all other exceptions in 2011, the pension and special education exceptions to the Act 1 index are the two remaining exceptions that are used by many districts each year, with pension driving the greatest requests for increases above the Act 1 index.

Why do school districts need Act 1 exceptions for pension and special education costs? In short, because these are mandated costs that increase dramatically each year. School districts must cover annual increases in these costs, increases that rise much faster than the Act 1 index, growth in property tax revenue or state funding. Eliminating these exceptions will not reduce costs for school districts, and will put them in the difficult position of having to make cuts to educational programs and services to pay for these mandates.

Why is the Pension Exception important? School districts are subject to hundreds of mandates that increase costs by millions of dollars each year. The biggest and most costly mandate on school districts is, by far, employee retirement costs. With the PSERS rate increasing so dramatically over the past several years, school districts must cover significant annual increases. While the Act 1 index helps provide school districts with some additional revenue to cover these rising costs, the index doesn't cover the annual PSERS increase. In 2013-14, the revenue generated from increasing taxes to the index didn't even cover 50% of the increase in school district PSERS costs. See the chart below illustrating how the PSERS costs have grown faster than revenue generated by the Act 1 index.

PSERS Increases Outpace Act 1 Index Revenue



SOURCE: Prepared by PASBO using PDE data from school district Annual Financial Reports and Act 1 index information.

The Act 1 exception for PSERS costs offers some relief from this rising cost, allowing school districts to increase taxes above the index for the purpose of reducing their pension obligations. Without this exception, school districts would have had to cut their way out of the \$264 million difference in this one mandate alone.

Why is the Special Education Exception important? Eliminating the special education exception would create significant hardship for many school districts, forcing them to make cuts to their regular education programs to cover increases in their special education costs. Special education costs generally increase much faster than the Act 1 index. For example, special education costs increased by 5% between 2011-12 and 2012-13 and by 6% between 2012-13 and 2013-14, outpacing the increase in the Act 1 index. Additionally, these costs may be unpredictable to school districts, as costs may dramatically increase due to new students moving into the district.

Eliminating the Act 1 exception for special education ignores the fact that school districts have no flexibility in providing special education services. Special education is heavily regulated by state and federal mandates, and school districts must provide appropriate services to each student with special education needs. While the additional special education cost of most students does not exceed \$25,000, it is not uncommon for a single student to have special education costs that exceed \$50,000 or even \$100,000 per year.

Finally, the elimination of this exception would disproportionately hurt those school districts that have a higher than average population of special education students. With a state average special education incidence rate of 15.4% for 2014-15, there are many school districts that serve a much higher percentage of special education students. For those districts, which include some that have served special education students so well that they have become a destination for parents, the elimination of this exception would be particularly detrimental.