



Pennsylvania Association of School Business Officials

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**Testimony of the PA Association of School Business Officials
House Finance Committee
May 2, 2011
Elimination of Act 1 Referendum Exceptions
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In some public policy issues, perception fuels reality. In the case of Act 1 exceptions, perception and reality are misaligned. In this testimony I would like to separate the perception about the Act 1 property tax exceptions and focus on the actual data about the extent to which exceptions are utilized by school districts since the passage of Act 1 in 2006.

The legislation before the committee, House Bills 1326 (Grove) and 1383 (DeLuca), would repeal in total all of the exceptions that were built into the law and have not been modified since enactment. We believe passage of any legislation removing the exceptions is unwarranted, unnecessary and will create short and long term financial chaos for school districts.

Act 1 put into place an Index that establishes an annual percentage increase that caps school district millage increases for property taxes. The Index is calculated equally using the increase in the Statewide Average Weekly Wage (SAWW) from the PA Department of Labor and the Employment Cost Index (ECI) for Elementary and Secondary Education, a national Index administered by the Bureau of Labor Statistics in the federal Department of Labor.

The exceptions under Act 1 provide a safety valve for districts that cannot meet budget requirements solely by an adjustment of property taxes by the allowable Index. When adopting Act 1 and its predecessor Act 72 the General Assembly correctly recognized that there may be financial circumstances for which relief from the cap is necessary. When a district’s budget is out of balance after the Act 1 Index is applied, there are three options: cut expenditures, use exceptions or seek a so-called back end referendum.

The back-end referendum option has been used in only a few cases and all have failed—most by lopsided margins. In fact, the Act 1 back-end referendum and the one-time front end option granted under Act 1 in May 2007 as well as debt votes under the Local Government Unit Debt Act all have a high failure rate. In the case of the front-end referenda votes required by Act 1, only 8 of the 501 school districts approved an exchange of increasing the Earned Income Tax for a reduction in property taxes. In the case of the back-end referendum under Act 1 and the Debt Act ballot questions, one passed and the other 13 failed as indicated in the following chart. Two districts have failed to obtain voter approval in two votes on the same project—Donegal and Unionville-Chadds Ford School Districts.

Voter Approval Fails—Most by Lopsided Margins

<u>Date</u>	<u>School District</u>	<u>County</u>	<u>Yes</u>	<u>No</u>
Nov-06	Bristol Twp.	Bucks	13%	87%
Nov-06	Ambridge	Beaver	16%	84%
Nov-06	Fannet-Metal	Fulton	NA	NA
Mar-07	Upper Dublin	Montgomery	62%	38%
Nov-07	Unionville-Chadds Ford	Chester/Delaware	40%	60%
Apr-08	Unionville-Chadds Ford	Chester/Delaware	46%	54%
Apr-08	Rockwood	Somerset	27%	73%
Apr-08	Forest Area	Forest	20%	80%
Jul-08	Wyomissing	Berks	10%	90%
Sep-08	Tuscarora	Franklin	28%	73%
Jan-09	Donegal	Lancaster	29%	71%
Feb-09	Crestwood	Luzerne	15%	85%
Nov-09	Donegal	Lancaster	48%	52%
Jan-11	Upper Merion	Montgomery	48%	52%

There is clear historical evidence that Pennsylvanians will vote no when given an opportunity to do so. Therefore school boards are not likely to view this option as anything other than an exercise in futility. If we look at school district millage rates as published by PDE many schools have not exceeded the Act 1 Index and, in fact, about 10% of all school districts have not raised property taxes in the last five years. Others have stayed within the Index and have not chosen to use any Act 1 exceptions. As a point of reference the Act 1 Index has been (since 2006-07) 3.9%, 3.4%, 4.4%, 4.1%, 2.9% and 1.4% for 2011-12.

Exceptions address costs, some of which are the result of state and federal mandates, which cannot be controlled by school boards. Other exceptions address emergency expenditures for such events as weather related damages, court ordered costs that schools may be required to pay, additional property taxes for debt payments and adjustment to millage rates when assessed values decline in order to maintain revenue neutrality. The exception for health care was only to protect benefits provided by collective bargaining agreements in effect upon the adoption of Act 1. This exception only applies to a few (if any) districts that still have a collective bargaining agreement that has not terminated since 2006.

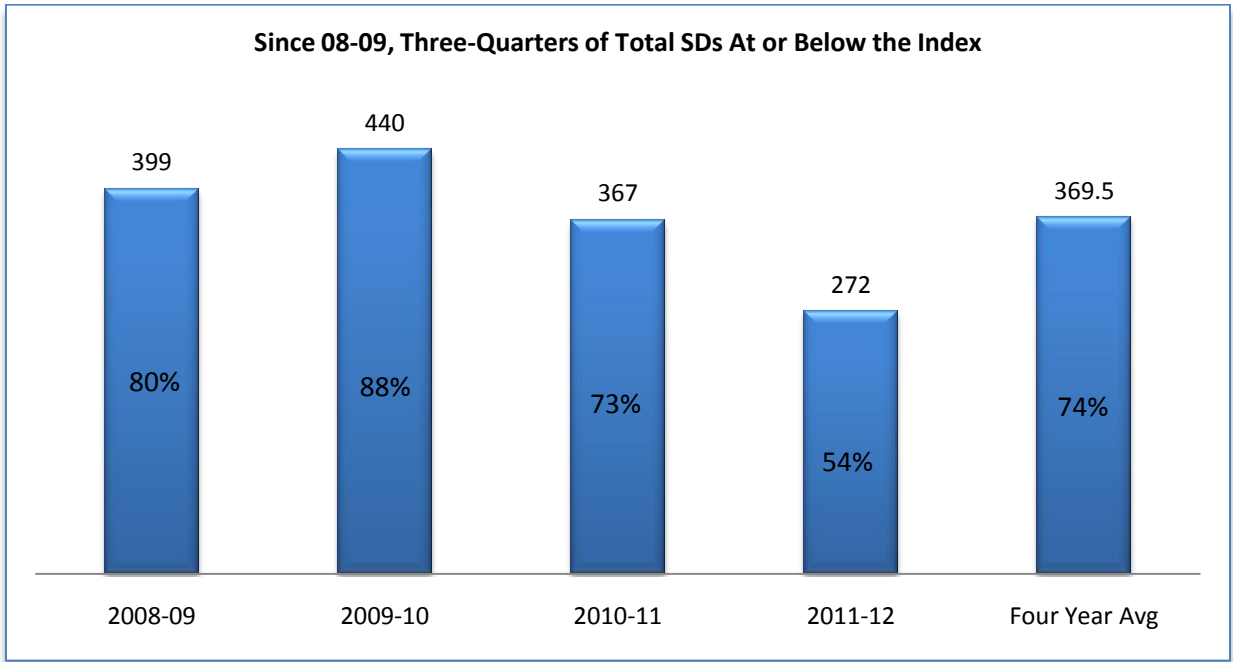
The next table summarizes the ten exceptions with the notation of whether the exception must be approved by the PA Department of Education or the Court of Common Pleas where the district is located:

The 10 Exceptions Available under Act 1

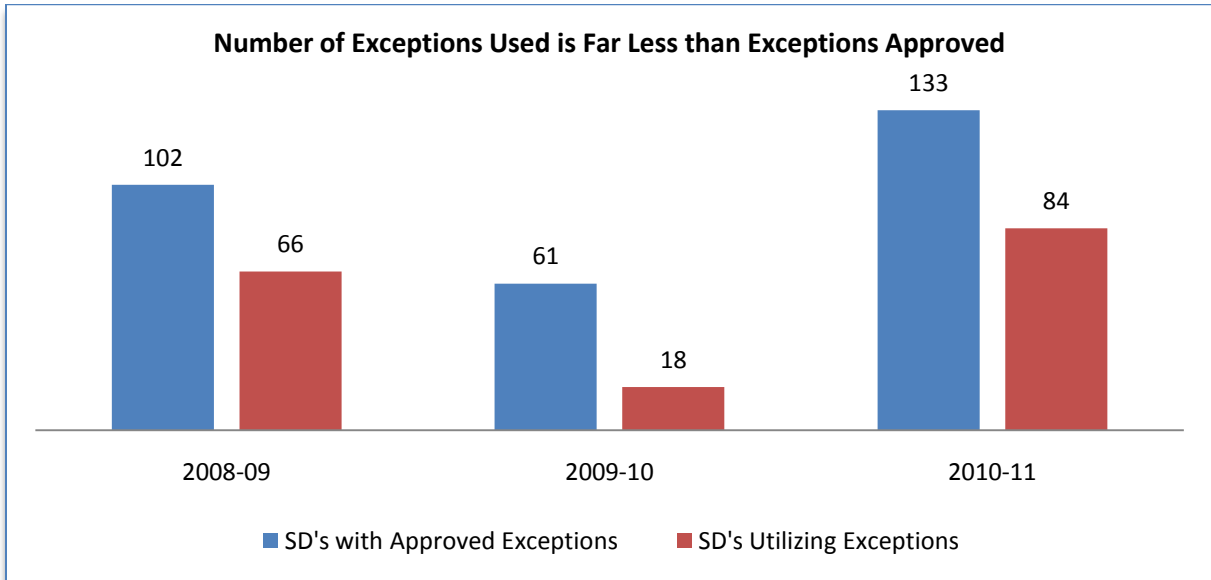
<u>PA Department of Education</u>	<u>Court of Common Pleas</u>
<ul style="list-style-type: none">• Principal and interest on debt• Special education cost increases	<ul style="list-style-type: none">• Emergencies and disaster response• Court/administrative orders (state or federal)
<ul style="list-style-type: none">• Costs for school improvement plan implementation• Maintenance of per student local tax revenue or maintenance of the Average Instructional Expense per Average Daily Membership• Retirement expenses• Maintenance of revenues from local taxes (income and real estate taxes) and state funding (basic and special education subsidies)• Health care cost increases under a current collective bargaining agreement	<ul style="list-style-type: none">• Costs to remedy an immediate threat of serious physical harm

The exceptions are not automatically granted. They are subject to an approval process either by the courts or by PDE. (The department is to be commended for creating an on-line filing process that removes any subjectivity from the process. Either Annual Financial Report data or school budget data is used in the calculations and the approval or denial of an exception filing is solely a look at financial data.)

We maintain that districts have been very judicious in the use of exceptions. As the chart below shows, a majority of districts have chosen not to file for exceptions. I believe in part that is a result of institutionalizing the Index, meaning that many school boards are using up to their Index but declining to exceed it by authorizing exceptions.

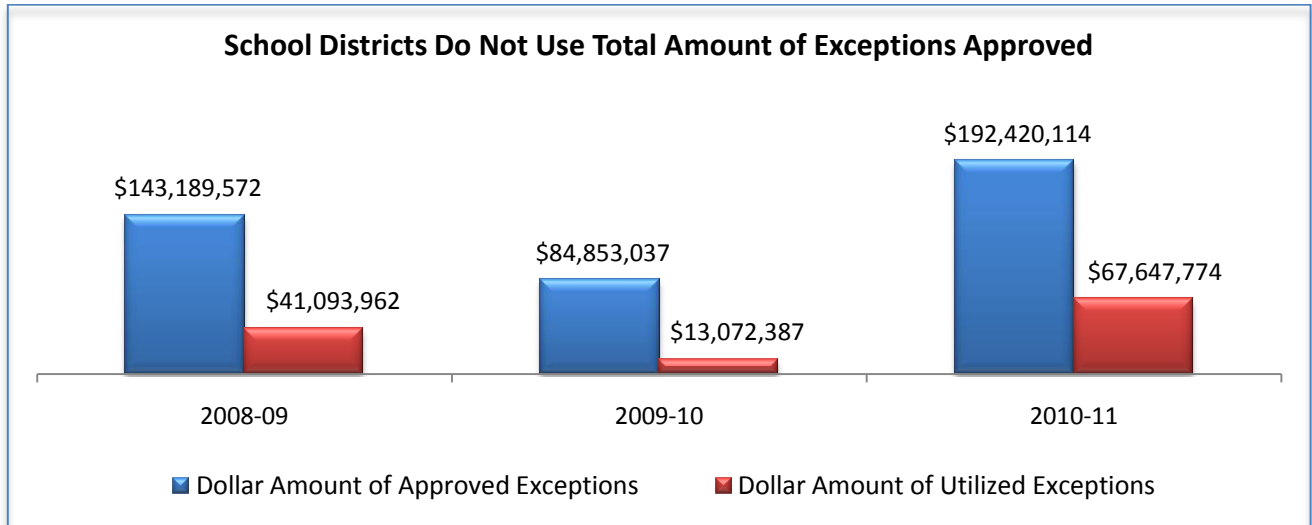


The perception that exceptions are over used is fueled by the front-end of the process that receives significant media coverage. Districts will often apply for exceptions to use in the budget process if necessary. Often they are unnecessary but that fact is usually not covered with the same scrutiny as the filing process. As the chart below shows, many districts file for exceptions as a safeguard but ultimately decide not to utilize them.



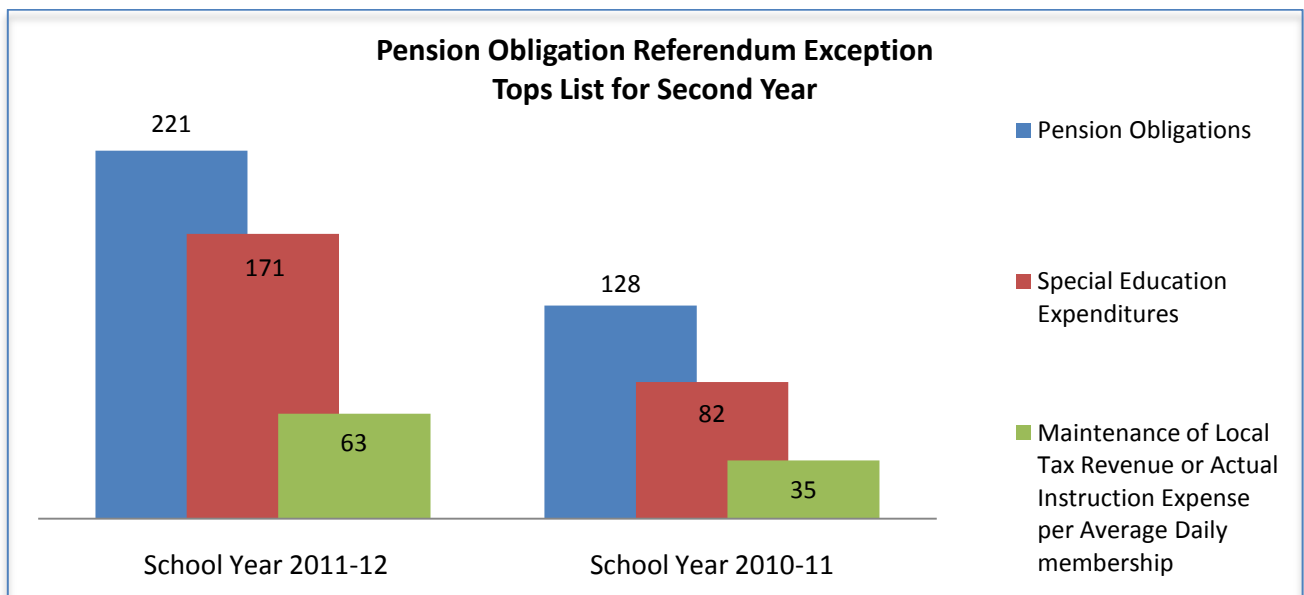
Looking at this chart we have actual data that shows that there are often unused exceptions. Why does this occur? First, filing for exceptions contains an early deadline. This year, for example, school districts were forced to file in early March actually in advance of the Governor's budget message. So it is a cautious move to file for exceptions in case they are needed at a point when final budget decisions have not been made. Second, exceptions are not automatic. As a result a school district may file just to make sure the exception will be approved and sometimes multiple filings are made in case others may be rejected. Once the deadline passes a school district cannot have any exceptions approved.

School districts routinely do not use exceptions allowed under Act 1. Even those that do, a school district utilizes only what is needed, not what is available. The next chart shows the dollar amount of approved exceptions and the dollar amount actually utilized in millage increases.



Exceptions are critical for schools. They allow flexibility and provide the ability to look at budget development in a longer term context. They also allow schools to forgo revenue increases that may be available under the Index because there is advance knowledge that additional revenues can be raised in subsequent years.

The record of the use of exceptions by districts clearly shows that mandated costs drive the use of exceptions. The next chart shows the most frequently filed and utilized exceptions. The leader is the exception for retirement costs for school employees followed by special education expenditures.



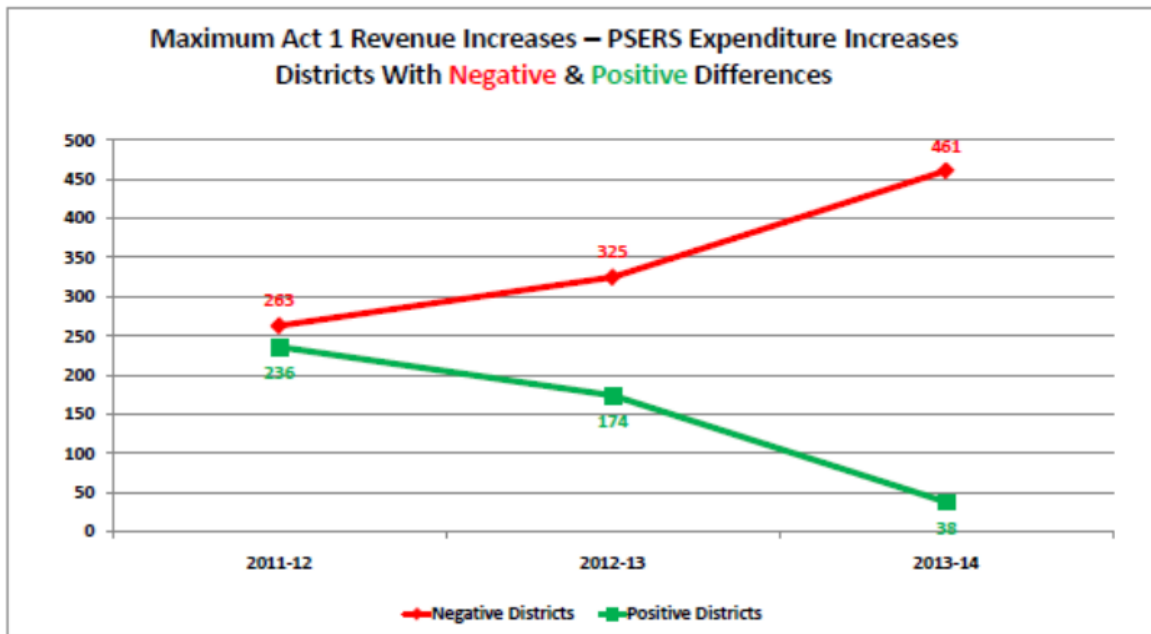
If the General Assembly passes and the Governor signs legislation removing all of the exceptions there will be financial chaos for schools. Eliminating all the exceptions will not only create severe financial consequences but will also drive school boards to increase school property taxes every year to the Index since there will be no flexibility in following fiscal years.

Here a few results we would suggest could occur if exceptions are repealed:

- Potential defaults on school bonds
- Acute financial distress in perhaps dozens of districts who are struggling now to balance budgets with the lowest Act 1 Index that trails the Consumer Price Index combined with a billion dollar plus cut in state assistance
- School construction projects will grind to a halt
- Potential default on pension payments to the Public School Employees Retirement System.

The next chart shows the very real scenario where the Act 1 Index will not provide the additional revenue next year for meeting the increased pension obligations for school employees. This chart prepared by Dr. William Hartman at Penn State University and Timothy Shrom, business manager, Solanco School District shows that only 35% of districts have sufficient new revenue to meet the increase in PSERS payments for 2012-13. This data used actual 2008-09 school payroll and property tax revenues that were adjusted by 3% per year to establish the base for 2011-12. The Act 1 Index is frozen at 1.4%, and there is no increase in salaries in the projection. The result is that in 2013-14, more than 90% of school districts don't produce enough revenue from the Act 1 Index to pay their pension obligation.

Act 1 Index Projection and Increased Cost of Retirement (PSERS)



The pension rate increase over the next three years is substantial. The increase in districts using exceptions for 2011-12 compared to previous years is the convergence of the lowest Act 1 Index since the inception of the law and the single largest increase in the Employer Contribution Rate to PSERS in decades.

Elimination of the exceptions under Act 1 changes the rules in the middle of the game. Schools are put in the position of having to seek voter approval that will take considerable time and reduce resources in the classroom for mandated expenses. What happens if voters say no to increasing property taxes for pension payments or special education expenditures? A “no” vote doesn’t give schools a pass on legally or contractually obligated expenses; it is a no win position.

Elimination of the exceptions under Act 1 also comes at the worst possible time. Districts are faced with a minimal Act 1 Index for 2011-12, and our estimate is that it could be even lower in 2012-13. With six months of the data for the SAWW and ECI that will be used in calculating the 2012-13 Index, the Index is projected to be lower than 1.4%. Further, there is a billion dollar plus reduction in state assistance. Taking away the exceptions will put school budgets further out of balance.

We urge you to carefully consider the significant ramifications to school budgets, students and parents before you vote to eliminate Act 1 exceptions. Thank you for the opportunity to present our position. I will be glad to respond to any questions you may have.

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