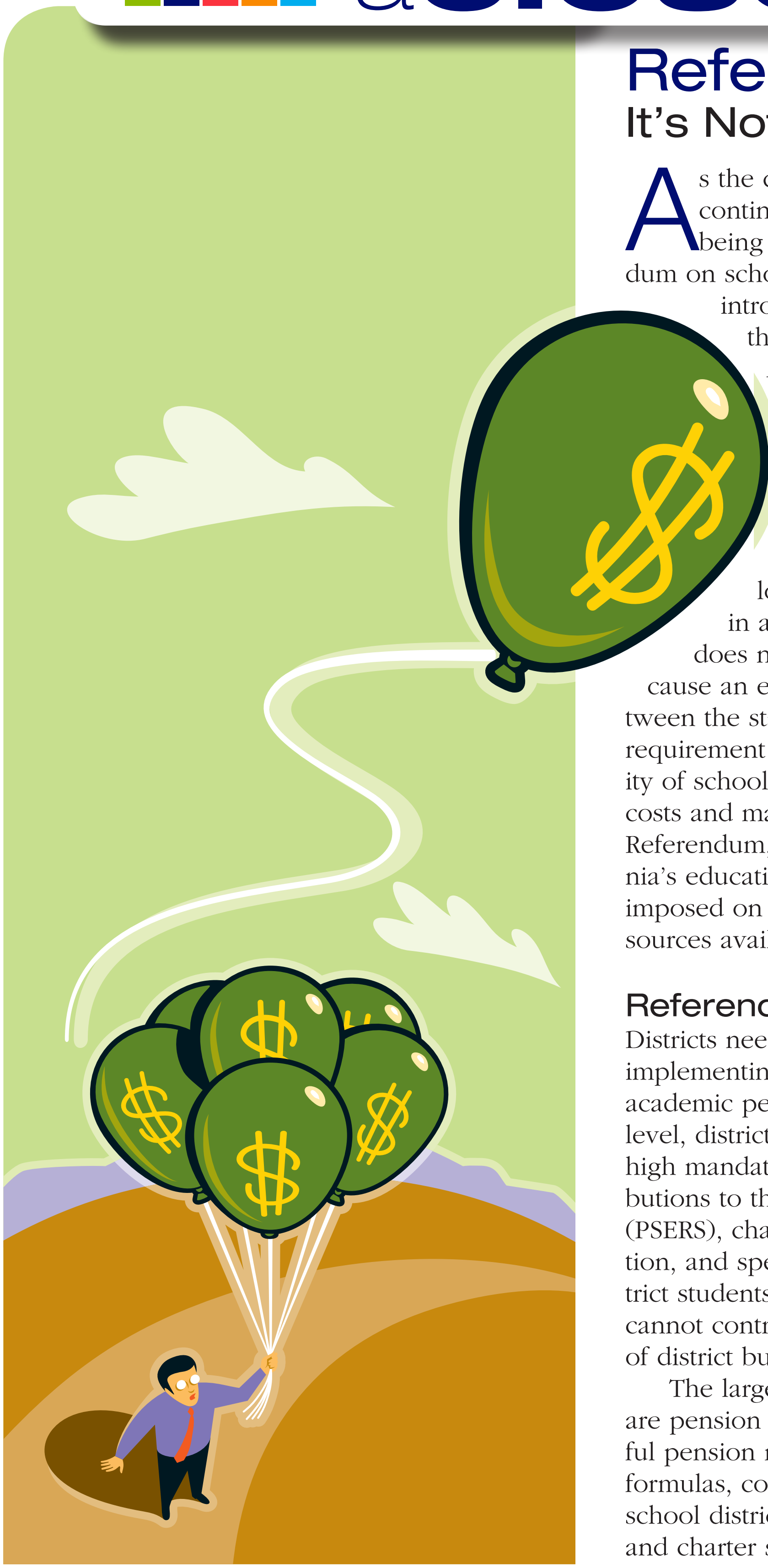
PSBA **a closer LOOK**

Referendum:
It's Not Tax Reform



As the discussion about school funding and tax reform continues in the General Assembly, one issue that is being mentioned as part of the solution is a referendum on school districts. One such example is legislation introduced in Senate Bill 909 (Sen. White, R-Indiana) that amends Act 1 of 2006 (The Taxpayer Relief Act) to eliminate the index and the remaining allowed exceptions. It effectively requires school districts to place a referendum question on the ballot for any and all property tax increases. While the idea of a referendum on school districts may sound like a solution, how would it work in the context of school funding and local tax reform? The answer is that referendum, in and of itself, actually accomplishes very little. It does not reduce property taxes. Referendum will not cause an equal sharing in the funding of education between the state and school districts. Instead, a referendum requirement for any tax increase would eliminate the ability of school boards to build a budget, pay for mandated costs and make tax decisions based on their financial needs. Referendum, combined with the shortcomings of Pennsylvania's education funding system and the number of mandates imposed on school districts, translates into fewer overall resources available for needed programs and student services.

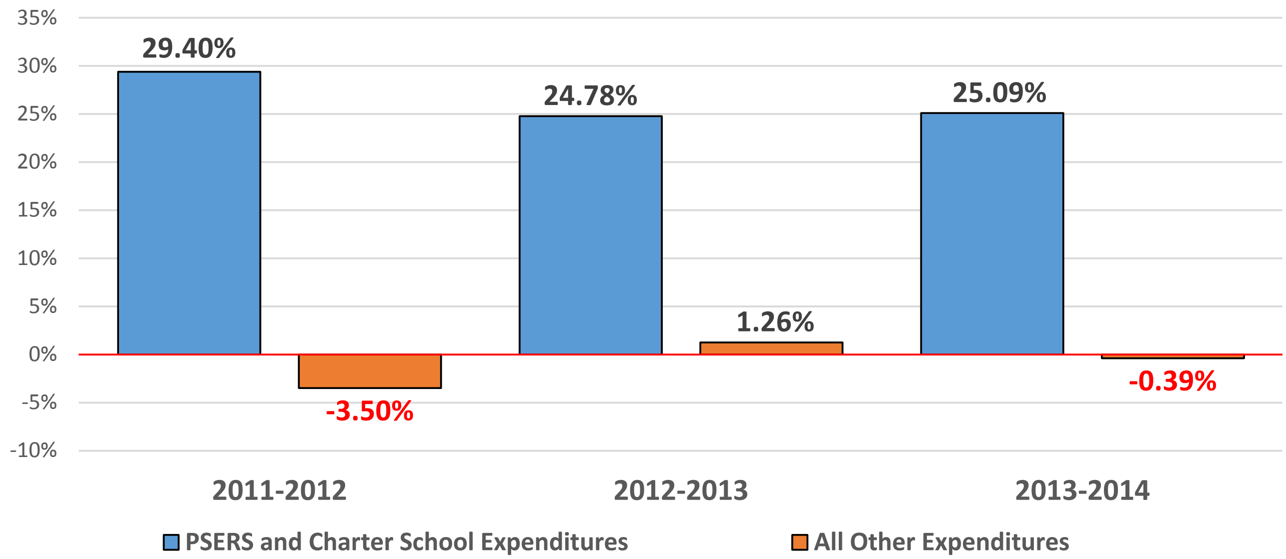
Referendum removes accountability

Districts need to be accountable for their decisions and for implementing programs that will result in the increased academic performance of their students. On a more practical level, districts also have to be able to pay for increasingly high mandated costs, including those for employer contributions to the Public School Employees' Retirement System (PSERS), charter school tuition for regular and special education, and special education programs and services for district students. These are mandated costs that school boards cannot control, and every year they consume larger portions of district budgets.

The largest and fastest growing costs for school districts are pension and charter school costs. Without meaningful pension reform, or significant changes to charter tuition formulas, costs continue to climb significantly above other school district expenditures. Over the past few years, PSERS and charter school costs combined were responsible for an aggregate annual increase in school district budgets of at least 25%. While often chided for "irresponsible spending," during the same period, all other school district expenditures combined (including salaries and healthcare) have increased by a maximum of 1.26%, and in two out of the past three years, those expenditures have actually decreased from the prior year.

CHART 1

Growth in School District Expenditures



SOURCE: PDE data from school district Annual Financial Reports.

Additionally, school districts often cannot control or anticipate any fluctuations in the costs of providing special education services for their own students. Special education is heavily regulated by state and federal mandates, and 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. These costs cannot be negotiated. If a school district cannot provide the required services, staff and resources for even one student, a time-consuming and expensive due process hearing or court case will likely result.

Referendum removes the accountability from school boards because they will not have the final say in the decisions that are made. Ironically, this would occur at the very same time that greater financial and academic accountability is being demanded of them. When referenda questions fail and districts are prevented from implementing necessary academic programs and services to students, providing adequate facilities and paying for costly mandates, who will be accountable for the performance of the schools?

Districts already face taxing restrictions

Act 1 has played an important role in slowing property tax growth since 2006. Under Act 1, districts are subject to a number of restrictions on the ability to raise taxes at the local level. Those restrictions include:

- Prohibiting school districts from levying a tax for the support of public schools that was not levied in the 2005-06 fiscal year by placing a referendum question on the ballot.
- Prohibiting school districts from raising their tax rate above the Act 1 index established by the PA Department of Education (PDE). The index is 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.
- Restricting the categories for exceptions. Act 1 originally allowed 10 exceptions; after the passage of Act 25 of 2011, the categories for exceptions to place a referendum question on the ballot when exceeding the rate in the

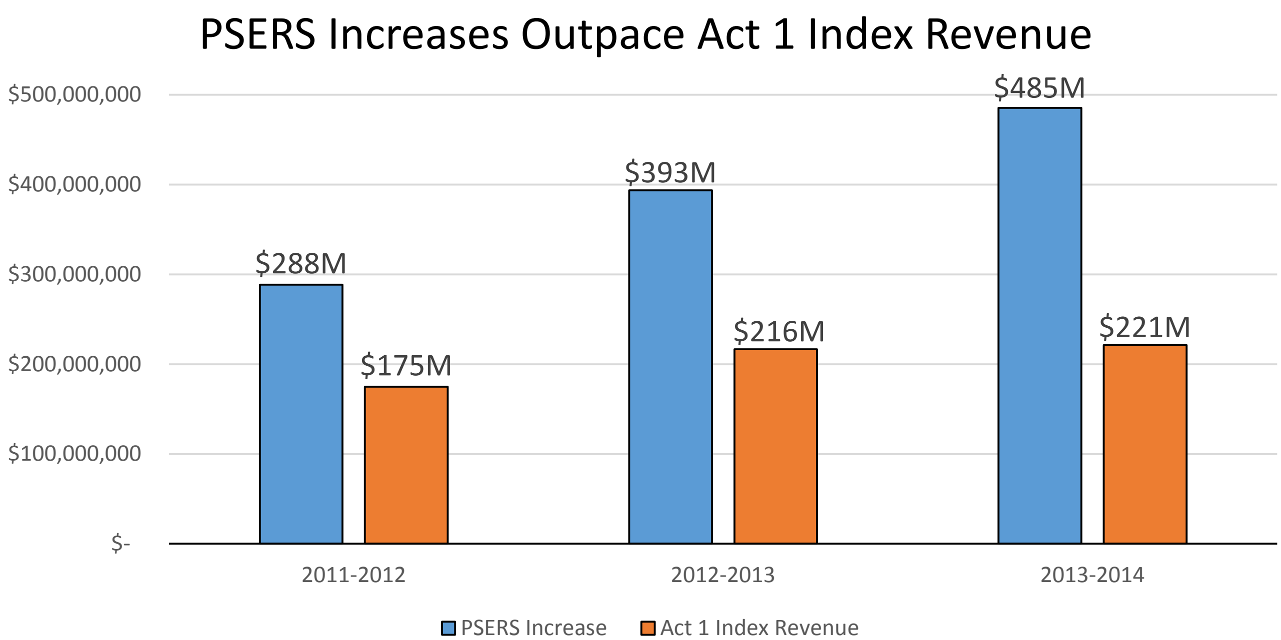
index are limited to four exceptions. They include electoral debt and grandfathered debt for school construction, special education expenditures and pension expenditures.

- Prohibiting school districts from using public funds to urge individuals to vote a specific way on a referendum ballot question.

The pension and special education exceptions are the two that are used by many districts each year, with pension driving the greatest requests for increases above the Act 1 index. 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.

While the Act 1 index helps provide school districts with some additional revenue to cover these rising costs, the index doesn't even begin to 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. 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. See the chart below illustrating how the PSERS costs have grown faster than revenue generated by the Act 1 index.

CHART 2



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

Referendum is not tax reform

Referendum treats the symptom of unpopular property taxes without treating the cause of the problem – an inadequate education funding system and too many unfunded and underfunded mandates. Rather than addressing these issues, proposals to eliminate the index and require referendum strips elected school boards of the ability to make tough financial decisions for their districts without any changes to the statutory processes under Act 1.

Budgeting will become even more difficult if school boards have no ability to make decisions on levying taxes. The exceptions provide a conservative safety net for districts that begin their budget process long before a state budget is enacted and are concerned they may not receive enough state funding to meet their budget requirements. The elimination of the index means districts would be subject to the current timelines and still be required to place a referendum on the ballot. Without the index and the exceptions, referendum would likely be certain in most districts every year. How would that work?

Proposals such as Senate Bill 909 do not provide a clear process for the implementation of back-end referendum. School districts would literally have to begin budget planning in January of each year so that they will be able to ascertain whether or not they think they will need to place a back-end referendum question on the ballot in the primary election. The early planning is needed in order for districts to meet the requirement that ballot questions must be submitted to the County Board of Elections 90 days before the election takes place. Districts also will need to have at least a ballpark estimate of the level of state funding they will be receiving in order to make a reasonable determination. Any estimation of state funding made by districts in January will be mostly speculation. Districts have no way of knowing in January how much the state budget will provide or even when they can expect the commonwealth to fulfill its statutory obligation to pass a budget.

Most referendum questions fail

Proponents of referendum believe that Pennsylvania voters will be willing to approve school tax and spending increases when they are convinced they are worthwhile. The fact is that in Pennsylvania, the vast majority of referenda have failed. Since 2006, there have been 16 referenda by school districts under Act 1 and the Local Government Unit Debt Act, and only two were successful. The remaining referenda were defeated by generally lopsided margins, showing that the public is not likely to approve such questions and demonstrating for school boards the futility of the referendum as a mechanism to obtain the resources they need to provide a quality education.

If the job of school boards is to convince the public the product being provided is worth additional taxpayer investment, then referendum changes their focus from making the best decisions in the interest of their students to one where the main thrust is to run a successful public relations campaign to ensure that their plan receives enough votes for approval. And although districts would have to place a referendum question on the ballot every time they need to increase taxes, they are prohibited from using any district funds to advocate for the passage of the referendum.

What really helps districts, taxpayers: funding reforms, mandate relief

The best tax reform will result from making changes to the current system of basic education funding. The lack of a reliable funding formula has led the state's property owners down a road of enduring tax increases. The work done by the bipartisan Basic Education Funding Commission to develop a new formula for funding schools must not be lost. The commission recommends a funding system more responsive to school district needs by focusing funds on conditions that exist in and among school districts. Such a system would reduce the dependency of school boards on the local property tax to fund public education.

Districts would also be able to retain more local dollars through reforms to the charter school funding system. Of particular need is the enactment of legislation that would apply the new special education funding formula under Act 126 of 2014 equally to charter schools just as it now applies to school districts.

Additionally, taxpayers will benefit from a restructuring of the pension system for public school employees. Pension reform will allow local district budgets to keep more state and local dollars in their schools.

Mandate relief is also an integral part of providing taxpayer relief. History has demonstrated that school officials can stretch available dollars further when restrictive state requirements are relaxed or repealed. For instance, some limited relief was achieved through the Mandate Waiver Program that was created under Act 16 of 2000 and expired in 2010. Act 16 saved the state's taxpayers millions of dollars, although it applied only to a few mandates.

Conclusion

Proposals to amend Act 1 of 2006 (The Taxpayer Relief Act) to eliminate the index and the remaining allowed exceptions are presented at a time when school districts are already struggling to maintain their financial operations. Presented as tax reform, this effort will undermine the ability of school districts to ensure they have adequate funding to pay for the mandated costs in educating students and maintaining the operations of the district.

Referendum is not tax reform. The consequences of proposals such as Senate Bill 909 would lead to critical, long-term fiscal distress for school districts. The options for them would be severely restricted and most likely be limited to cutting back existing programs, services and activities for students. If referendum becomes the law, the biggest loss would be felt by the students.

PSBA acknowledges the Pennsylvania Association of School Business Officials (PASBO) in the preparation of this Closer Look report.