



INDEPENDENT FISCAL OFFICE

Second Floor, Rachel Carson State Office Building
400 Market Street
Harrisburg, Pennsylvania 17105

January 4, 2017

The Honorable Jim Cox
Pennsylvania House of Representatives
209 Ryan Office Building
Harrisburg, PA 17120

Dear Representative Cox:

This letter responds to your request for Independent Fiscal Office (IFO) forecasts of certain school district data relating to your work on proposals to eliminate school property taxes. The data include (1) updated forecasts for school property taxes and debt service and (2) a new forecast for school district earned income taxes.

The forecasts do not reflect a specific proposal and do not incorporate any assumptions regarding the parameters that might become part of a future proposal. Therefore, refinements to the forecasts will be needed if one wishes to incorporate specific cut-off dates for property taxes or new debt service similar to past proposals. Once those details are identified, my staff could assist you in making the computations to arrive at a baseline estimate that is consistent with your proposal.

Property Taxes

Table 1 (next page) provides the IFO's forecast of school property taxes for fiscal years (FY) 2017-18 through 2021-22, a time period consistent with the office's recently published five-year economic and budget outlook. The most recent actual data on school property tax collections are for FY 2014-15, and the office used published school district millage rates to estimate collections for FYs 2015-16 and 2016-17. The Pennsylvania Department of Education (PDE) is expected to publish actual collections for FY 2015-16 in late spring 2017.

The forecast for FY 2017-18 and thereafter is based on the Act 1 index and exceptions, which limit school district millage rate increases.¹ (See Enclosure 1 for additional detail regarding the computations used to develop the forecast.) The base index is the average of the percentage change in the national employment cost index (ECI) for elementary and secondary schools and the percentage change in the 36-month statewide (Pennsylvania) average weekly wage (SAWW).² School districts with a market value / personal income aid ratio (MV/PI AR) equal to or greater

¹ Act of June 27, 2006, Special Session 1, P.L. 1873, No. 1, known as the "Taxpayer Relief Act."

² The ECI is reported by the U.S. Bureau of Labor Statistics. The SAWW is reported by the Pennsylvania Department of Labor and Industry.

Table 1
School Property Tax Forecast

Fiscal Year	Actual	Estimate		Forecast				
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Current & Interim	\$12,285	\$12,627	\$12,907	\$13,325	\$13,802	\$14,325	\$14,867	\$15,427
Act 1 Allocations ¹	530	530	532	530	530	530	530	530
Delinquent ²	<u>417</u>	<u>422</u>	<u>429</u>	<u>439</u>	<u>450</u>	<u>464</u>	<u>480</u>	<u>498</u>
Total	13,232	13,579	13,868	14,294	14,782	15,319	15,877	16,455

Note: dollar amounts in millions.

¹ Actuals through FY 2016-17. Estimated at \$530 million annually thereafter.

² Delinquent property taxes are not reported separately. All years are estimated by the IFO.

than 0.4 are assigned an adjusted index that increases with the aid ratio.³ School districts not eligible for an adjusted index are assigned the base index. A school district must obtain voter approval or qualify for an exception to raise property tax millage rates above the level indicated by its index.⁴

The IFO projects the base index and estimates the adjusted index for each school district with an MV/PI AR greater than 0.4. The results are weighted by property tax collections to obtain a statewide average index. (Enclosure 2 provides detail on the base index and the weighted index.) The weighted index is used to estimate the amount of revenue that can be obtained statewide each year through millage increases without exception or referendum.⁵ Some school districts do not raise millage rates to the level permitted by the index, and an historical utilization percentage is applied to obtain a projection of the revenues from index-permitted millage increases.

Projected revenues are sensitive to changes in the base index due to the relationship between school property tax collections and the index. PDE published a base index of 2.5 percent for FY 2017-18, and the methodology suggests that a 0.5 percentage point change in the index (to 2.0 percent or 3.0 percent) would change projected revenues by approximately \$60 million. After five years, an index that is consistently 0.5 percentage points higher or lower than the one used in the forecast could alter projections by \$300 million or more.

The analysis projects that the growth rate of the Consumer Price Index (CPI) will increase from the unusually low rate experienced in recent years to a rate of approximately 2.2 percent annually.⁶ Educational costs and average wages used to compute the base index are assumed to grow by about 1 percentage point higher than inflation. If the CPI or the cost / wage differential diverges from the projection, the property tax forecast would also be affected due to the relationship between the CPI, the index and property tax collections.

³ The adjusted index equals the base index multiplied by the sum of 0.75 and the school district's MV/PI AR.

⁴ Applications are submitted to and reviewed by the Pennsylvania Department of Education.

⁵ Base revenues include current and interim collections and Act 1 allocations for the prior year and the estimated growth in assessed values from new construction and assessments in the current year. Taxable assessments are assumed to increase by 0.75 percent annually.

⁶ The inflation forecast is consistent with the forecast for calendar years 2018 through 2022 presented in the *Economic & Budget Outlook, Fiscal Years 2016-17 to 2021-22*, Independent Fiscal Office, November 2016.

The forecast also incorporates property tax increases that occur through the exceptions process authorized under Act 1. Exceptions are allowed for certain increases in pension, special education and certain grandfathered debt service expenditures. The IFO forecasts exception approvals and applies a historical utilization percentage to project the value of exceptions that will be used in each fiscal year.

The IFO's school property tax forecast assumes there are no material changes in state or federal funding for school districts and that the share of revenues provided by other sources of local revenue is consistent with recent history. Enclosure 3 provides a snapshot of school district revenues in five-year increments, and Enclosure 4 provides a multi-year history of school property tax collections.

Debt Service

Table 2 provides a history of debt outstanding and debt service for the five most recent fiscal years for which data are available. Debt outstanding represents the amount of outstanding debt of all fund types at the beginning of the fiscal year. Debt service represents the expenditures in each fiscal year that go towards the repayment of debt.⁷ Property tax revenue is included to reveal the historical relationship between debt service and property tax revenue. Declines in debt service payments for FYs 2013-14 and 2014-15 likely can be attributed to an increased level of debt refinancing spurred by low interest rates.

Table 3 (next page) displays projected debt service expenditures and property tax revenue from FY 2015-16 to FY 2021-22. The debt service projection assumes that (1) it will average approximately 18 percent of annual property tax revenue and (2) it will increase as school districts incur additional debt and exhaust savings from refinancing and as interest rates increase after 2016.

Table 2
Debt History

Fiscal Year	2010-11	2011-12	2012-13	2013-14	2014-15
Debt Outstanding ¹	\$25,863	\$26,547	\$26,184	\$26,269	\$28,098
Debt Service ²	2,249	2,246	2,409	2,327	2,223
Property Tax Revenue ³	11,688	12,002	12,225	12,524	12,815
Debt Service as % ⁴	19.2%	18.7%	19.7%	18.6%	17.3%

Note: dollar amounts in millions.

¹ Debt outstanding from all funds at the beginning of the fiscal year.

² Includes debt service expenditures and transfers to sinking funds.

³ Includes current and interim real estate tax collections and Act 1 allocations.

⁴ Debt service as a percentage of property tax revenue.

⁷ Categorized in the annual financial reports as debt service or transfers to sinking funds.

Table 3
Debt Service Projections

Fiscal Year	Debt Service	Property Tax Revenue¹
2015-16	\$2,360	\$13,157
2016-17	2,413	13,439
2017-18	2,494	13,855
2018-19	2,580	14,332
2019-20	2,674	14,855
2020-21	2,771	15,397
2021-22	2,872	15,957

Note: dollar amounts in millions.

¹ Includes current and interim real estate tax collections and Act 1 allocations.

Earned Income Taxes

The request seeks an estimate of the revenue that would need to be replaced if school district income taxes were capped at 0.5 percent. Table 4 provides a projection of earned income tax collections through FY 2021-22, with separate projections for the districts that levy the tax at (1)

Table 4
Earned Income Tax Projections

Fiscal Year	EIT @ 0.5% 381 Districts	EIT Above 0.5% 85 Districts		Total EIT Collections
		0.5%¹	> 0.5%²	
2014-15	\$933	\$228	\$314	\$1,476
2015-16	965	236	325	1,525
2016-17	994	243	334	1,571
2017-18	1,030	252	347	1,628
2018-19	1,072	262	361	1,694
2019-20	1,116	273	375	1,764
2020-21	1,161	284	391	1,835
2021-22	1,207	295	406	1,909

Note: dollar amounts in millions. Excludes Philadelphia.

¹ For districts with a rate exceeding 0.5 percent, this column includes EIT collections attributable to the first 0.5 percentage points of the rate.

² Includes the projected EIT collections attributable to the rate in excess of 0.5 percentage points. Represents the fiscal impact of capping the rate at 0.5 percent.

January 4, 2017

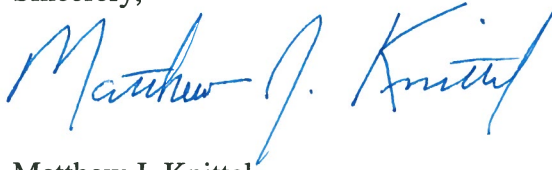
Page 5

a 0.5 percent rate and (2) a rate greater than 0.5 percent.⁸ For the second group of districts, the table also indicates the revenue associated with the portion of the rate in excess of 0.5 percent. This column can be used to estimate the impact of capping the rate.

The projections are based on (1) earned income tax revenues published by PDE for FY 2014-15, (2) earned income tax rates published by the Department of Community and Economic Development and (3) wage growth forecasted by the IFO in its recent five-year economic and budget outlook. Projected wage growth is based on a statewide average, and the same growth rate is applied to each group of districts.

I hope that you find this information useful. Consistent with IFO policy, this letter will be posted to the office's website no later than the third business day following transmittal. Please do not hesitate to contact me if you have any questions or comments.

Sincerely,



Matthew J. Knittel
Director

Enclosures

⁸ There are 33 school districts that do not levy an earned income tax. According to data from the Pennsylvania Departments of Education and Community and Economic Development, no school district levies a personal income tax.

School Property Tax Forecast Detail

Fiscal Year	2017-18	2018-19	2019-20	2020-21	2021-22
Current, Interim and Act 1 Allocations - Prior Year	\$13,439	\$13,855	\$14,332	\$14,855	\$15,397
Revenue Growth - Current Year					
Economic Growth (from changes in assessed value)	101	104	107	111	115
Act 1 Index	275	339	385	399	414
Act 1 Exceptions	<u>40</u>	<u>34</u>	<u>31</u>	<u>32</u>	<u>31</u>
Subtotal - Current Year Revenue Growth	416	477	523	542	560
Current, Interim and Act 1 Property Tax Collections	13,855	14,332	14,855	15,397	15,957
Less: Act 1 Allocations from the Property Tax Relief Fund	<u>-530</u>	<u>-530</u>	<u>-530</u>	<u>-530</u>	<u>-530</u>
Current and Interim Property Tax Collections	13,325	13,802	14,325	14,867	15,427
Add: Delinquent Property Tax Collections	<u>439</u>	<u>450</u>	<u>464</u>	<u>480</u>	<u>498</u>
Total Property Tax Collections	14,294	14,782	15,319	15,877	16,455
<i>Detail: Act 1 Index Growth</i>					
Baseline Collections (Prior Year + Economic Growth)	\$13,540	\$13,959	\$14,439	\$14,966	\$15,512
Weighted Average Index	2.9%	3.5%	3.8%	3.8%	3.8%
Potential Revenue Growth from Index	\$393	\$484	\$550	\$570	\$591
Index Utilization Rate	70.0%	70.0%	70.0%	70.0%	70.0%
Forecast Growth from Index	\$275	\$339	\$385	\$399	\$414
<i>Detail: Act 1 Exceptions</i>					
Pension Exception	\$63	\$38	\$24	\$20	\$6
Special Education Exception	\$65	\$69	\$76	\$83	\$91
Debt Exception	<u>\$5</u>	<u>\$5</u>	<u>\$5</u>	<u>\$5</u>	<u>\$5</u>
Subtotal - Exceptions	\$133	\$112	\$105	\$108	\$102
Exception Utilization Rate	30.0%	30.0%	30.0%	30.0%	30.0%
Forecast Growth from Exceptions	\$40	\$34	\$31	\$32	\$31

Note: dollar amounts in millions.

History and Forecast of the Act 1 Index

Fiscal Year	SAWW¹	ECI²	Base Index³	Weighted Index⁴
2007-08	2.8%	4.0%	3.4%	4.3%
2008-09	4.3	4.5	4.4	4.9
2009-10	4.6	3.6	4.1	4.6
2010-11	2.7	3.0	2.9	3.3
2011-12	0.9	1.9	1.4	2.0
2012-13	2.1	1.3	1.7	1.9
2013-14	2.0	1.4	1.7	1.9
2014-15	2.6	1.5	2.1	2.5
2015-16	2.4	1.4	1.9	2.5
2016-17	2.5	2.2	2.4	2.7
2017-18	2.6	2.3	2.5	2.9
2018-19	3.2	2.8	3.0	3.5
2019-20	3.2	3.3	3.3	3.8
2020-21	3.2	3.3	3.3	3.8
2021-22	3.2	3.3	3.3	3.8

¹ Statewide Average Weekly Wage.

² Educational Cost Index.

³ Average of the SAWW and ECI.

⁴ Average of the index for each school district weighted by property tax collections. Philadelphia is not subject to property tax restrictions based on the index, but it is represented in the weighted index computation based on actual (or projected) collections. Significant increases in Philadelphia real estate tax collections in FYs 2007-08 and 2011-12 increased the weighted index.

Sources: Pennsylvania Department of Education (base index and components through FY 2017-18) and IFO (base index and components after FY 2017-18 and weighted index for all years).

Sources of Revenue for Pennsylvania School Districts

Revenue Source	FY 1999-00		FY 2004-05		FY 2009-10		FY 2014-15	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Local Taxes								
Real Estate ¹	\$6,471	43.1%	\$8,915	45.0%	\$10,757	43.7%	\$12,285	44.5%
Earned Income ²	723	4.8%	1,001	5.0%	1,186	4.8%	1,476	5.4%
1st Class SD ³	134	0.9%	148	0.7%	172	0.7%	389	1.4%
Other Local Tax ⁴	464	3.1%	426	2.1%	333	1.4%	389	1.4%
Delinquent ⁵	<u>420</u>	<u>2.8%</u>	<u>528</u>	<u>2.7%</u>	<u>624</u>	<u>2.5%</u>	<u>638</u>	<u>2.3%</u>
Total Local Tax	8,212	54.7%	11,018	55.6%	13,072	53.1%	15,177	55.0%
Local Other ⁶	<u>421</u>	<u>2.8%</u>	<u>536</u>	<u>2.7%</u>	<u>702</u>	<u>2.9%</u>	<u>709</u>	<u>2.6%</u>
Local Subtotal	8,633	57.5%	11,554	58.3%	13,775	56.0%	15,887	57.6%
Act 1 Allocations ⁷	0	0.0%	0	0.0%	527	2.1%	530	1.9%
State (excl. Act 1)	5,685	37.9%	7,135	36.0%	8,228	33.4%	9,492	34.4%
Federal	533	3.6%	851	4.3%	1,770	7.2%	815	3.0%
Other ⁸	<u>152</u>	<u>1.0%</u>	<u>289</u>	<u>1.5%</u>	<u>320</u>	<u>1.3%</u>	<u>855</u>	<u>3.1%</u>
Total	15,003	100.0%	19,829	100.0%	24,620	100.0%	27,578	100.0%

Note: dollar amounts in millions.

¹ Current and interim real estate taxes.

² Act 1, Act 511 and First Class A SD earned income taxes.

³ Philadelphia SD taxes including liquor sales, cigarette, business use and occupancy, realty transfer and mercantile.

⁴ Includes Public Utility Realty Tax, state and federal payments in lieu, Act 511 taxes excluding Earned Income & First-Class SD, and Section 679 per capita tax.

⁵ Includes real estate and non-real estate delinquent taxes.

⁶ Includes revenues from investments, district activities, local government units, rentals, contributions, tuition, other LEAs, and refunds of prior year expenditures. Also includes federal revenue from other public schools and federal IDEA revenues as a pass-through.

⁷ Distributions to reimburse school districts for homestead exclusions. Included as state revenue in PDE reports. Did not exist prior to FY 2007-08.

⁸ Includes proceeds for bond issues, refunding of bonds, bond premiums, Commonwealth loans, other extended-term financing and sale of fixed assets.

Source: Pennsylvania Department of Education. Growth rates computed by IFO.

School Property Taxes: Total Collections by Fiscal Year

Fiscal Year	Total Current & Interim Real Estate Taxes Collected	Act 1 Property Tax Reduction Allocations¹	Total Real Estate Taxes (Current, Interim & Allocations)	Increase Over Prior Year	Percent Increase	10-Year Average
2021-22	\$ 15,427,000	\$ 530,000	\$ 15,957,000	\$ 560,000	3.6%	2.9%
2020-21	14,867,000	530,000	15,397,000	542,000	3.6%	2.8%
2019-20	14,325,000	530,000	14,855,000	523,000	3.6%	2.8%
2018-19	13,802,000	530,000	14,332,000	477,000	3.4%	2.7%
2017-18	13,325,000	530,000	13,855,000	416,383	3.1%	2.8%
2016-17	12,907,000	531,617	13,438,617	281,394	2.1%	3.0%
2015-16	12,627,000	530,223	13,157,223	342,562	2.7%	3.4%
2014-15	12,284,745	529,916	12,814,661	347,344	2.8%	3.7%
2013-14	11,942,000	525,317	12,467,317	243,113	2.0%	4.1%
2012-13	11,694,873	529,331	12,224,204	217,908	1.8%	4.6%
2011-12	11,480,469	525,827	12,006,296	322,661	2.8%	5.3%
2010-11	11,153,412	530,223	11,683,635	397,124	3.5%	5.5%
2009-10	10,759,582	526,929	11,286,511	321,693	2.9%	5.7%
2008-09	10,438,463	526,355	10,964,818	490,768	4.7%	5.9%
2007-08	10,474,050	-	10,474,050	463,331	4.6%	5.9%
2006-07	10,010,719	-	10,010,719	559,857	5.9%	5.8%
2005-06	9,450,862	-	9,450,862	540,974	6.1%	5.7%
2004-05	8,909,888	-	8,909,888	605,659	7.3%	5.4%
2003-04	8,304,229	-	8,304,229	542,219	7.0%	5.2%
2002-03	7,762,010	-	7,762,010	564,558	7.8%	5.1%
2001-02	7,197,452	-	7,197,452	381,838	5.6%	5.0%
2000-01	6,815,614	-	6,815,614	341,480	5.3%	5.3%
1999-00	6,474,134	-	6,474,134	281,673	4.5%	5.9%
1998-99	6,192,461	-	6,192,461	292,668	5.0%	6.4%
1997-98	5,899,793	-	5,899,793	207,669	3.6%	6.7%
1996-97	5,692,124	-	5,692,124	257,023	4.7%	7.1%
1995-96	5,435,101	-	5,435,101	189,004	3.6%	7.3%
1994-95	5,246,097	-	5,246,097	264,978	5.3%	7.6%
1993-94	4,981,119	-	4,981,119	244,888	5.2%	7.9%
1992-93	4,736,231	-	4,736,231	330,954	7.5%	8.0%
1991-92	4,405,277	-	4,405,277	348,451	8.6%	7.9%
1990-91	4,056,826	-	4,056,826	394,131	10.8%	-
1989-90	3,662,695	-	3,662,695	330,572	9.9%	-
1988-89	3,332,123	-	3,332,123	255,208	8.3%	-
1987-88	3,076,915	-	3,076,915	209,524	7.3%	-
1986-87	2,867,391	-	2,867,391	182,348	6.8%	-
1985-86	2,685,043	-	2,685,043	160,810	6.4%	-
1984-85	2,524,233	-	2,524,233	184,798	7.9%	-
1983-84	2,339,435	-	2,339,435	146,334	6.7%	-
1982-83	2,193,101	-	2,193,101	142,122	6.9%	-
1981-82	2,050,979	-	2,050,979	-	-	-
Average					5.3%	

Note: dollar amounts in thousands.

¹ Excludes allocations for Philadelphia, which are dedicated to wage tax rate reductions.

Source: Pennsylvania Department of Education. Forecast and growth rates by IFO.