

# THE MORNING CALL

## Plan to eliminate property taxes gives Lehigh Valley school officials nightmares

By Andrew Wagaman  
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The school property tax may be on the outs, exciting taxpayer associations but terrifying school officials.

Most Lehigh Valley school districts rely heavily on property taxes — much more so than districts statewide, on average.

That's why district officials are worried about a movement to eliminate the tax that has been gaining momentum in the Legislature since the election.

Buoyed by a coalition of taxpayer associations, state Sen. David Argall, R-Schuylkill, is expected to reintroduce a bill he sponsored in 2015 that died on a tie-breaking vote cast by Lt. Gov. Mike Stack, Argall's office confirmed last week. He and others have said changes in the Senate this term — two newly elected senators have said they will support the bill — make passage more likely.

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Paying careful attention will be school directors and administrators from 15 Lehigh Valley school districts which, a Morning Call analysis found, derive at least half of their revenues from property taxes. With those taxes come stability and certainty, said John Vignone, director of business administration for the Parkland School District, which claims a region-high 71 percent of its total funding from the property tax.

Navigating budget season without that tax, Vignone said, is the stuff of nightmares for school business administrators. This school year, that tax generated \$900 million collectively for the Lehigh Valley's 17 districts.

"There's nothing a financial person wants to avoid more than uncertainty," Vignone said. "I think the legislators incorrectly think this will solve all the issues. It's a tax shift. You're still going to have the issues."

[The 2015 bill](#) called for replacing property taxes with a new pot of money created by increasing the state personal income tax from 3.07 percent to 4.95 percent, and the sales tax from 6 percent to 7 percent. Sales taxes also would apply to more items, such as legal, accounting and financial services; funeral services; and tickets to concerts and sporting events.

The shift, supporters argue, would not only ease the burden of homeowners, especially those on fixed incomes, but also would freeze the growing inequity between property-wealthy districts such as Parkland and property-poor districts such as Allentown, which derives only 28 percent of its revenue from property taxes.

Even opponents of the shift acknowledge that reform is needed. Property tax hikes over the past 25 years have outpaced inflation and wage growth, according to the Pennsylvania Independent Fiscal Office. And the tax can't sustain the growing price of education without the burden becoming much more onerous for homeowners.

But school officials argue that abolishing the school property tax means putting education funding almost entirely in the hands of a state government whose myopic policies fostered the property tax dependency in the first place.

They and many economists also argue relying on taxes that are more vulnerable to economic changes is a recipe for disaster, considering schools are government-mandated to implement many programs, no matter the cost.

David Baldinger, spokesman for the [Pennsylvania Coalition of Taxpayer Associations](#), an alliance of 87 groups supporting the shift, doesn't buy those arguments.

"School districts feel they should be immune to changes in the economy, but the people funding school districts are not immune to those changes," he said. "Homeowners are fighting for their survival."

### **Comparison to other states**

Lehigh Valley homeowners likely would pay less in taxes overall if the legislation were to pass, though for some, the relief would be modest.

In the East Penn School District, for example, the average property owner would no longer be on the hook for \$4,350. But the same taxpayers also could no longer take advantage of the related federal income tax deduction. And while the average East Penn resident paid \$2,222 in personal income tax in 2014, under the shift that person would pay closer to \$3,600.

Arguably, the biggest winners in a tax shift would be owners of commercial and industrial real estate. Statewide, they would be relieved of about \$3 billion in school tax, about \$2 billion of which individual taxpayers would pick up, according to the Pennsylvania Association of School Business Officials.

Property tax growth, at about 5 percent annually, has slowed a little over the past decade. But Pennsylvania remains above average relative to other states.

According to the U.S. Census' 2014 American Community Survey, 41 percent of Pennsyl-

vanians paid \$3,000 or more in property taxes compared to 34 percent nationally. Pennsylvania's effective property tax rate is 1.54 percent, [13th nationally according to the Tax Foundation](#), a Washington, D.C., think tank focused on U.S. tax policies.

And in an [update released last month](#), the Independent Fiscal Office forecast school property taxes to increase an average 3.5 percent annually over the next five years.

But Pennsylvania is not unlike other states in its dependence on the tax. Public schools in most states rely heavily on the local property tax, which comprised 37 percent of total school revenues nationwide in 2013, [according to the National Center for Education Statistics](#). In more than a handful of states, the property tax covers more than half of total funding.

Property taxes provide schools with a more reliable source of revenue because they don't fluctuate with economic changes the way income and sales taxes do. In Pennsylvania, year-to-year annual growth rates for the sales tax has ranged from -4.2 to 7.9 percent over the past two decades, according to the Independent Fiscal Office. The range for the personal income tax was even more volatile, from -6.5 percent to 8.8 percent. The range for the school property tax: 2.6 to 7.2 percent.

**Even when property tax growth declines, as it did in the Great Recession, the drop tends to lag a few years behind the drops in income and sales taxes, [according to a 2012 analysis by the Rockefeller Institute](#). By the time the property tax collections nationwide began declining in late 2010, sales and income tax revenue had begun to rebound.**

"For all their other faults property taxes help balance the revenue portfolio for public services," Bruce Baker, a professor at Rutgers University's Graduate School of Education, [wrote on his blog School Finance 101](#) in 2012. "They are the stable, safer investment in that portfolio. Shifting too dramatically away from property taxes places a greater burden on the state to provide additional state aid for property wealthy and property poor districts. And we know who's likely to win out in that tug of war."

To assist Pennsylvania policymakers in their deliberations of property tax reform, the Independent Fiscal Office in 2013 [analyzed the impact reform had on Michigan](#) after it reduced local property taxes, hiked sales and cigarette taxes and implemented a state education property tax.

Michigan's reform did reduce property tax burdens and narrowed per-pupil funding disparities between wealthier and poorer districts, the analysis found. But revenue had not kept pace with inflation, and that led to schools taking on dramatically more debt.

Shifting control from the local level to the state level usually results in fewer resources spent on education in the long term, according to Andrew Reschovsky, an economist and fellow at the Lincoln Institute of Land Policy in Cambridge, Mass. After California restricted property tax growth in 1978, the state's spending per pupil dropped from among the highest in the country to among the lowest today, Reschovsky said.

Public education, he said, will face a challenging paradox in the years to come: While the popularity of the school property tax continues to decline, dependency on it likely will grow because many states, including Pennsylvania, face growing unfunded pension liabilities and rising Medicaid costs. [Education funding will compete with other fiscal needs for shrinking resources.](#)

Under the 2015 bill, districts would lose their primary means of keeping up with rising costs. The shift also would limit the districts' take of the sales and income taxes to the amount each district currently collects in property taxes, with an increase allowed only to account for a so-called "cost-of-living" factor.

For example, the Nazareth Area School District budgeted about \$49 million in property tax revenue for this school year. If the Legislature eliminated the school property tax tomorrow, the replacement fund next year and every year after that would dole out \$49 million to Nazareth Area, multiplied by a "cost of living" factor that would be based on the lesser of two things: the percentage increase in the average weekly wage, or the averaged increase in the

combined sales and hotel occupancy taxes. Both have grown at slower rates than the property tax, so the replacement funding would not keep pace with forecast school spending growth.

[The Independent Fiscal Office concluded in 2013](#) that replacement funding would "fall short of the property taxes that would be eliminated, creating a negative fiscal impact for the districts."

Unless lawmakers are willing to reduce education mandates, which many districts already have a difficult time funding with allotted state dollars, a tax shift will put districts in a tough bind, school officials say.

"This is slipshod legislation offering a knee-jerk solution to a very complex problem," said Chuck Ballard, a longtime East Penn School District school director and former vice president of the Pennsylvania School Boards Association. "There's no guarantee the state would relieve us of the unfunded mandates they've imposed, and we would have no way to pay for them other than cutting educational programs."

Argall was unavailable for comment last week.

If the shift happens, school districts could still levy a property tax to pay off existing debt. But they would need a voter referendum to take on new debt, which could wreak havoc with schools' capital improvement plans.

Rightfully so, argues Baldinger. Many school boards, he contends, spend "like drunken sailors" on facilities and amenities such as artificial turf fields, and then blame unfunded mandates for tax hikes. The Legislature's biggest mistake was giving school boards the right of taxation in the first place, he said.

A referendum might compromise a nearly \$100 million five-year plan [Easton Area School District recently adopted](#) that calls for, among other things, rebuilding or renovating four elementary schools. The district planned to borrow money to pay for the projects.

Investing in capital projects to keep facilities safe is an important component of every

school district, said Superintendent John Reinhart.

"I'm not sure how they think districts will be able to do that if we can't add that tax to the taxpayers beyond December of this past year," he said.

### **Competing for dollars**

There is another pot of money for school funding, the basic education subsidy, which the Legislature would continue even after a tax shift. That money accounts for less than 15 percent of the revenues for most Lehigh Valley districts this year, The Morning Call analysis found. And those allocations would still be subject to the fancy of lawmakers.

With Pennsylvania currently facing a [projected \\$3 billion budget shortfall](#), school districts would prefer not to be in competition for a greater share of state funds.

The Senate bill offers no solution to the problems districts now face in meeting expenses that they have no ability to reduce, said Steve Robinson, senior director of communications for the Pennsylvania School Boards Association. And most school districts simply don't have much fat to cut from their budgets, he added.

"The proposal does not address the true cost-drivers of public education spending — pensions, charter tuition payments, special education costs and health care," Robinson said.

"All are costs out of the control of the local school board."

Property taxes have enabled districts to deal with those rising costs, said Joseph Kovalchik, superintendent for the Northampton Area School District.

He acknowledged that he too does not enjoy paying his annual property tax bill. But he's not sure how Northampton would cover an expected 12 percent hike in pension and charter school payments next year if property taxes are eliminated.

"I don't want to see people losing their houses and struggling," Kovalchik said. "Something needs to be managed and adjusted. But Harrisburg needs to make sure that by making these adjustments they can provide an adequate funding source for public schools."

Baldinger agrees that the tax shift would not address pension costs and other issues. But he argues that such legislation would compel lawmakers to address them. Without a property tax, the state could no longer pass the buck to hamstrung school districts. Something would have to give.

"Harrisburg will be forced to deal with this, and they know it," Baldinger said. "This is going to cause a cascade."

*Reporters Sarah Wojcik, Michelle Merlin and Jacqueline Palochko and database editor Eugene Tauber contributed to this story.*