**Legislative Fiscal Bureau**
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: http://legis.wisconsin.gov/lfb

May 18, 2017 Joint Committee on Finance Paper #585

# Levy Limit Adjustment for Debt Service on Debt Issued Before 2005 (Shared Revenue and Property Tax Relief -- Property Taxation)

[LFB 2017-19 Budget Summary: Page 417, #2]

## CURRENT LAW

The state's levy limit program prohibits any county, city, village, or town from increasing its "base" levy in any year by more than the percentage change in the local government's January 1 equalized value due to new construction, less improvements removed, between the previous year and the current year, but not less than zero percent. The base levy is defined as the prior year actual levy for the county or municipality. State law provides for adjustments and exclusions to the limit. Increases above the limit can be approved through the passage of a referendum, although towns with a population under 3,000 can exceed the limit by a vote at the annual town meeting or at a special town meeting.

## GOVERNOR

Delete the current law provision that allows counties and municipalities to refrain from decreasing their allowable levies by the amount that their debt service on debt issued before July 1, 2005 decreases between the prior year and the current year. Under a provision included in the 2011-13 biennial budget, if the amount of debt service in the preceding year on debt originally issued before July 1, 2005, is more than the amount of debt service needed in the current year for such debt, the allowable levy under the levy limit is decreased by the difference between the two amounts. However, the same provision exempts a county or municipality from having to decrease its allowable levy if it does not claim a separate adjustment under which it carries forward unused levy authority from a prior year. The bill would delete this exemption from the required reduction and require counties and municipalities to reduce their levies by the amount of the reduction in annual debt service associated with this type of debt. The proposed modification to the levy limit program would first apply to amounts levied in December, 2017.

## DISCUSSION POINTS

### Levy Limit History

1. Since its creation by 2005 Wisconsin Act 25, the levy limit program has limited the year-to-year increases in county and municipal property tax levies. During this period, the allowable level of increase has been tied to the percentage change in each local government's equalized value due to net new construction. However, in the program's first six years, the limit extended a guaranteed, minimum level of increase:

**TABLE 1**

**Guaranteed Minimum Levels of Increase Under Levy Limit Program**

| Year | Minimum Increase |
|---|---|
| 2005(06) | 2.00% |
| 2006(07) | 2.00 |
| 2007(08) | 3.86 |
| 2008(09) | 2.00 |
| 2009(10) | 3.00 |
| 2010(11) | 3.00 |

2. The guaranteed, minimum level of increase was eliminated by 2011 Wisconsin Act 32, and since 2010(11), each local government's increase has been limited to the percentage change in the local government's equalized value due to net new construction. In theory, this mechanism should apportion any levy increase to "new" value and "freeze" the levy on existing value. This mechanism should result in the county and municipal portion of the tax bill for properties existing in 2010 being unchanged over the six tax years since then, provided other factors have remained unchanged.

3. Of course, other factors affecting tax bills have changed. For example, properties appreciate in value at different rates, and some taxable properties become exempt. Also, the entire municipal and county levy is not subject to the control because the levy limit program allows for adjustments and exclusions to the allowable levy. Nonetheless, the levy limit program has been effective in controlling tax bill increases since 2010(11). For some time, this office has produced estimates of the property tax bill on a median-valued home taxed at the statewide average tax rate. Table 2 displays these estimates and the tax bill change amounts on a year-to-year basis. These estimates indicate that over the six years since 2010(11), the municipal portion of the tax bill has increased at an average annual rate of 1.3%, and the county portion of the tax bill has increased at an average annual rate of 0.6%. Both rates of these are lower than the average change in the inflation rate over the period. From 2010 through 2016, the average annual change in the consumer price index for all urban consumers (CPI-U) equaled 1.6%.

## TABLE 2

### Estimated Municipal and County Portion of Tax Bill Estimates for a Median-Valued Home Taxed at Statewide Average Tax Rates, 2010(11) through 2016(17)

| | 2010(11) | 2011(12) | 2012(13) | 2013(14) | 2014(15) | 2015(16) | 2016(17) | Average Change |
|---|---|---|---|---|---|---|---|---|
| Home Value | $161,355 | $157,692 | $151,148 | $147,989 | $150,505 | $152,719 | $155,657 | |
| Municipal | $813 | $822 | $827 | $833 | $847 | $859 | $877 | |
| - Change | | 9 | 5 | 6 | 14 | 12 | 18 | |
| - Percent | | 1.1% | 0.6% | 0.7% | 1.7% | 1.4% | 2.1% | 1.3% |
| County | $655 | $659 | $657 | $657 | $664 | $672 | $680 | |
| - Change | | 4 | -2 | 0 | 7 | 8 | 8 | |
| - Percent | | 0.6% | -0.3% | 0.0% | 1.1% | 1.2% | 1.2% | 0.6% |
| CPI-U, 12-Mo. Avg. | | 3.2% | 2.1% | 1.5% | 1.6% | 0.1% | 1.3% | 1.6% |

4. Because some taxes each year are borne by the value resulting from new construction, statewide municipal and county tax levies have increased at slightly higher average rates than the tax bill amounts reported in Table 2. The six-year average annual rate of change equals 2.1% for municipalities and 1.5% for counties. Table 3 reports the year-to-year change in statewide municipal and county tax levies.

## TABLE 3

### Statewide Municipal and County Property Tax Levies (in millions), 2010(11) through 2016(17)*

| | 2010(11) | 2011(12) | 2012(13) | 2013(14) | 2014(15) | 2015(16) | 2016(17) | Average Change |
|---|---|---|---|---|---|---|---|---|
| Municipal | $2,422.5 | $2,463.2 | $2,499.1 | $2,549.2 | $2,611.0 | $2,668.3 | $2,749.7 | |
| - Percent | | 1.7% | 1.5% | 2.0% | 2.4% | 2.2% | 3.1% | 2.1% |
| County | $1,951.4 | $1,972.2 | $1,986.4 | $2,011.0 | $2,046.5 | $2,086.5 | $2,131.7 | |
| - Percent | | 1.1% | 0.7% | 1.2% | 1.8% | 2.01% | 2.2% | 1.5% |

* Amounts for 2016(17) are preliminary.

5. As noted above, the levy limit program limits the year-to-year increase in each local government's tax levy to the percentage change in the local government's tax base due to new construction, plus adjustments and exclusions. In 2010(11), the levy limit allowed a 3% minimum

increase to every municipality and county, and the statewide increases in those levies equaled only 2.1% and 1.9%, respectively. While adjustments and exclusions were important to some local governments in 2010(11), they appear to have had limited impact on the statewide change in levies. For the five years after the 3% minimum was eliminated, adjustments and exclusions have comprised over half of the statewide increase in municipal levies and over 40% of the statewide increase in county levies. Table 4 displays the change in statewide municipal and county tax levies and the reason for change from 2010(11) through 2015(16). Levy limit data for the 2016(17) levy has not yet been compiled because those levies are preliminary.

**TABLE 4**

**Percent Change in Statewide Municipal and County Levies and Percent Change Due to Net New Construction and Due to Adjustments and Exclusions, 2010(11) - 2015(16)**

| | Municipalities | | | Counties | | |
|---|---|---|---|---|---|---|
| | Total Change | Net New Construction | Adjustments & Exclusions | Total Change | Net New Construction | Adjustments & Exclusions |
| 2010(11) | 2.1% | 3.0%* | N.A. | 1.9% | 3.0%* | N.A. |
| 2011(12) | 1.7 | 0.7 | 1.0% | 1.1 | 0.6 | 0.5 |
| 2012(13) | 1.5 | 0.7 | 0.8 | 0.7 | 0.6 | 0.5 |
| 2013(14) | 2.0 | 0.9 | 1.1 | 1.2 | 0.8 | 0.4 |
| 2014(15) | 2.4 | 1.1 | 1.3 | 1.8 | 0.9 | 0.9 |
| 2015(16) | 2.2 | 1.2 | 1.0 | 2.0 | 1.0 | 1.0 |

* In 2010(11), if a local government's net new construction percentage was less than 3.0%, a minimum increase of 3.0% was allowed. In subsequent years, the new construction percentage for counties is less than the same percentage for municipalities because the base levy for counties differs from the base levy for municipalities.

6. The levy limit program allows a limited amount of unused levy authority to be carried forward and used in subsequent years, prompting municipalities and counties to claim more adjustments than they actually use. As a result, adjustments claimed on levy limit reports often sum to totals that exceed the change in tax levy, so it is problematic to directly tie tax levy increases to specific adjustments and exclusions. However, due to the magnitude of the various adjustments and exclusions claimed, much of the increase attributable to adjustments and exclusions is related to debt service on general obligation bonds and notes.

**Governor's Proposal**

7. The levy limit treatment of general obligation debt service differs depending on whether the debt was authorized before or after 2005, the year the levy limit law was enacted. Debt service on debt authorized on or after July 1, 2005, is excluded from the limit. For debt authorized before that date, an adjustment is provided if the debt service on the debt increases in the year of the levy in comparison to the prior year, and the adjustment equals the amount of the increase. The Wisconsin Constitution requires local governments incurring debt to "provide for … a direct annual

tax sufficient to pay the interest … and discharge the principal" [Article XI, Section 3(3)], and bond counsel maintained at the time of the law's enactment that the levy limit could not impede debt repayment without violating the Constitution.

8. In the 2011-13 biennial budget act, a third debt-related provision was enacted that requires the levy to be reduced if debt service on pre-2005 debt is lower in the year of the levy than in the prior year. The levy limit adjustment equals the amount of the debt service decrease. In the same act, the Legislature enacted a second adjustment that allows local governments to carry forward unused levy authority (resulting from a local government setting its levy at a level below its allowable levy under the levy limit) and using that authority to increase the allowable levy in a subsequent year. To limit the amount of carryover authority used in subsequent years, the Legislature adopted a complementary provision that eliminates the requirement for a municipality or county to lower its levy in years when debt service on pre-2005 debt decreases, provided the municipality or county does not use a carry-forward adjustment in the same year.

9. The Governor's proposal in AB 64/SB 30 would eliminate the linkage between the two provisions. If a local government's debt service on pre-2005 debt is lower in the year of the levy than in the prior year, the local government would be required to reduce its levy authority by the amount of the decrease. It would not be able to avoid the decrease by not claiming the carry-forward adjustment. Eliminating the link between the two adjustments would remove a constraint on using the carry-forward adjustment. This could result in higher municipal and county levies, provided the amount of carry-forward adjustment exceeds the amount of debt service reduction. However, DOA indicates that the proposal is estimated to lower municipal and county levies by $22.0 million in 2017(18) and $36.6 million in 2018(19).

10. In the Governor's Budget in Brief, the effect of this and several other budget provisions on property taxes is highlighted as one of the budget's primary policy objectives. Using this office's tax bill calculation procedure, the Budget in Brief cites two benchmarks by reporting that the tax bill estimates for the next two years are below the tax bill estimate of $2,963 for 2010(11), the year before the Governor took office, and the tax bill estimate of $2,831 for 2014(15), the lowest estimate since the Governor took office. On March 14, 2017, this office released its estimate of property tax levels under the Governor's budget and calculated the tax bill on a median-valued home taxed at the statewide average tax rate at an estimated $2,832 in 2017(18) and $2,831 in 2018(19). While slightly higher than the Budget in Brief estimates, the 2018(19) estimate would meet one of the cited benchmarks. Without the bill's levy limit provision related to pre-2005 debt, tax bills on a median-valued home, calculated under the procedure described above, would be higher by an estimated $7 in 2017(18) and $11 in 2018(19).

11. The state's capital finance office indicates that a majority of municipal and county debt is issued with a ten-year maturity, which could indicate that there may not be a significant amount of pre-2005 municipal and county debt that has not yet been retired. This was confirmed by a partial survey of counties by the Wisconsin Counties Association (WCA). Nonetheless, the Wisconsin Constitution allows maturities up to 20 years, and WCA reported two counties with debt retiring in 2021 and 2025. The League of Wisconsin Municipalities also reported several of its members had pre-2005 debt still outstanding.

**Additional Levy Limit Flexibility**

12. Two municipalities offered analysis of the proposal's impact on their communities. Generally, when a local government's levy for an adjusted purpose is extinguished, that levy authority becomes available for other purposes. One municipality described its adoption of a long-term strategy to use its levy authority that becomes available to replace bonding for local road infrastructure with "pay-as-you-go" cash financing. This strategy was estimated to save the municipality $5 million over 10 years by eliminating the interest costs on debt. If the Governor's proposal is adopted, the municipality indicates it will continue to borrow for road projects, and the interest cost on the debt will cause some road maintenance projects to be delayed.

13. Another municipality commented that the levy limit is already so restrictive as to constrain the municipality's ability to provide basic services expected by residents and the levy authority related to extinguished debt offers the municipality needed flexibility to meet its residents' needs. The statewide levy limit database confirms that the limit has become more restrictive. The program was restructured in 2011, and the amount of unused levy authority in 2011(12) totaled $27.5 million for municipalities and $11.9 million for counties. For 2015(16), the amount of unused levy authority had decreased to $5.8 million for municipalities and $2.9 million for counties. With statewide 2015(16) tax levies of $2,668 million and $2,086 million, respectively, the amount of unused authority represents 0.2% of total municipal levies and 0.1% of total county levies.

14. This diminished flexibility may have been exacerbated by Wisconsin's state aid policy toward municipalities and counties. Table 5 displays the municipal and county revenue composition for the five largest revenue sources for 2011, 2013, and 2015, based on financial reports these governments filed with DOR. During this period, municipal and county reliance on state aid has decreased, as the percentage of revenues comprised of state aid has declined from 14.5% to 12.9% for municipalities and from 22.5% to 20.1% for counties. Over the same period, reliance on the property tax has remained stable -- about 29% of municipal revenues and 28% of county revenues. Presumably, the levy limit program has contributed to this stability. As reliance on state aid has decreased, other revenue sources have grown in importance as municipalities and counties have increased their reliance on other taxes, public charges, and long-term debt.

**TABLE 5**

**Municipal and County Revenue Composition,**
**2011, 2013, and 2015**

| | Municipalities | | | Counties | | |
|---|---|---|---|---|---|---|
| | 2011 | 2013 | 2015 | 2011 | 2013 | 2015 |
| State Aid | 14.5% | 13.2% | 12.9% | 22.5% | 20.4% | 20.1% |
| Property Taxes | 29.2 | 29.4 | 29.2 | 28.0 | 27.9 | 28.4 |
| Other Taxes | 2.7 | 2.9 | 3.1 | 5.3 | 5.4 | 5.8 |
| Public Charges | 14.3 | 14.7 | 15.0 | 20.0 | 19.9 | 20.7 |
| Long-Term Debt Proceeds | 10.1 | 12.5 | 12.8 | 3.4 | 2.9 | 4.4 |

15. For municipalities and counties, the largest state aid programs are county and

municipal aid (formerly shared revenue) and general transportation aid. County and municipal aid is unrestricted and can be used for any public purpose, while general transportation aid must be deposited in a local segregated account and used for transportation-related expenditures. Funding for both programs was reduced in 2012. The funding level for county and municipal aid is unchanged since then, and each year, local governments receive the same aid payment they received in the prior year. Funding for general transportation aid increased in 2015, but remains below the 2011 total. General transportation aid payments to individual local governments change from year to year based on a distribution formula. Table 6 reports the funding history for these programs since 2011. The budget bill proposes an increase in funding for general transportation aid, but not for county and municipal aid. Under the budget, combined state aid would total $979.0 million for municipalities and $233.7 million for counties. This office is preparing budget papers on the funding levels for each of those programs.

**TABLE 6**

**Funding Levels for the State's Two Largest Local Assistance Programs for Municipalities and Counties, 2011 - 2017 (Millions)**

| | Municipalities | | | Counties | | |
|---|---|---|---|---|---|---|
| | County and Municipal Aid | General Transportation Aid | Combined State Aid | County and Municipal Aid | General Transportation Aid | Combined State Aid |
| 2011 | $678.1 | $328.5 | $1,006.6 | $151.7 | $104.4 | $256.1 |
| 2012 | 630.4 | 308.9 | 939.3 | 122.6 | 94.6 | 217.2 |
| 2013 | 630.4 | 308.9 | 939.3 | 122.6 | 94.6 | 217.2 |
| 2014 | 630.4 | 308.9 | 939.3 | 122.6 | 94.6 | 217.2 |
| 2015 | 630.4 | 321.3 | 951.7 | 122.6 | 98.4 | 221.0 |
| 2016 | 630.4 | 321.3 | 951.7 | 122.6 | 98.4 | 221.0 |
| 2017 | 630.4 | 321.3 | 951.7 | 122.6 | 98.4 | 221.0 |

16. Table 7 combines the municipal and county levy totals from Table 3 with the state aid totals in Table 6, and compares the annual change in combined revenues to the annual change in the inflation rate. For municipalities, the change in the inflation rate exceeded the change in combined revenues in two years, and the change in combined revenues exceeded the inflation rate in three years. The two changed at the same rate in one year (2014). For counties, the change in the inflation rate exceeded the change in combined revenues in three years, and the change in combined revenues exceeded the inflation rate in three years. However, if the 2010 combined revenues had increased at the same rate as inflation in each of the six years, the additional amount available for expenditure over the entire period would have totaled $822.4 million for municipalities and $636.8 million for counties (the sums of the final column in Table 7). Some may contend that provisions in 2011 Wisconsin Act 10 relating to public employee costs have given municipalities and counties the ability to absorb these below-inflation funding levels. Also, if municipalities and counties need additional spending authority, levy increases can be approved through referendum or at town meetings.

## TABLE 7

### Combined Tax Levy and State Aid Amounts for Municipalities and Counties Since 2011 and Comparison to Inflation-Adjusted Amounts ($ Million)

| | Combined Levy and Aid | Inflation Adjusted Total | Combined Change | Inflation Rate | Difference (Col. 1 - Col. 2) |
|---|---|---|---|---|---|
| **Municipalities** | | | | | |
| 2011 | $3,429.1 | | | | |
| 2012 | 3,402.5 | $3,537.4 | -0.8% | 3.2% | -$134.9 |
| 2013 | 3,438.4 | 3,610.6 | 1.1 | 2.1 | -172.2 |
| 2014 | 3,488.5 | 3,663.4 | 1.5 | 1.5 | -174.9 |
| 2015 | 3,562.7 | 3,722.9 | 2.1 | 1.6 | -160.2 |
| 2016 | 3,620.0 | 3,727.3 | 1.6 | 0.1 | -107.3 |
| 2017 | 3,701.4 | 3,774.4 | 2.2 | 1.3 | -73.0 |
| | | | | | -$822.4 |
| **Counties** | | | | | |
| 2011 | $2,207.5 | | | | |
| 2012 | 2,189.4 | $2,277.2 | -0.8% | 3.2% | -$87.8 |
| 2013 | 2,203.6 | 2,324.3 | 0.6 | 2.1 | -120.7 |
| 2014 | 2,228.2 | 2,358.4 | 1.1 | 1.5 | -130.2 |
| 2015 | 2,267.5 | 2,396.6 | 1.8 | 1.6 | -129.1 |
| 2016 | 2,307.5 | 2,399.5 | 1.8 | 0.1 | -92.0 |
| 2017 | 2,352.7 | 2,429.8 | 2.0 | 1.3 | -77.1 |
| | | | | | -$636.8 |

17. This paper affirms that the levy limit program has been effective at controlling growth in municipal and county property tax levies and limiting property tax bill increases. If the Committee wants to further limit those increases, it could approve the Governor's proposal to eliminate the linkage between the negative adjustment for debt service on pre-2005 debt and the carry-forward adjustment (Alternative 1). If the Committee believes that municipalities and counties should be given the flexibility to re-purpose the tax levies for expiring pre-2005 debt, it could remove the Governor's recommendation from the bill (Alternative 2). This would increase combined municipal and county levies by an estimated $22.0 million in 2017(18) and $36.6 million in 2018(19), relative to the estimates under the budget. Estimated property tax bills on the statewide median-valued home would be higher by $7 in 2017(18) and $11 in 2018(19).

18. Further, if the Committee believes the levy limit program has been too restrictive in limiting municipal and county levies, it could authorize a minimum increase, which could be either a specified percentage or a percentage based on the inflation rate (Alternative 3). The difference between the growth in net new construction and the inflation rate is difficult to predict, particularly on a municipal by municipal or county by county basis. In the two most recent years, the statewide net new construction percentage exceeded the inflation rate calculated under the expenditure restraint program (the change in the consumer price index in the one-year period ending in September), so this alternative would have had a minor statewide effect on levies in 2015(16) and 2016(17). However, in the three preceding years, the inflation rate exceeded the statewide net new construction percentage by 1%, on average. If this alternative added 1.0% to municipal and county

levies on a statewide basis, levies would be higher by $43.9 million in 2017(18) and $45.2 million in 2018(19), compared to the estimates under the Governor's proposal. Estimated tax bills would be higher by $14 both in 2017(18) and in 2018(19).

19. Another option that would offer flexibility would be to extend additional levy authority if it is used for a specified purpose. During the Committee's public hearings on the budget bill, a number of municipal officials offered testimony on the difficulty of funding road improvements. In 2015, municipalities funded over half of their road construction and maintenance expenditures with long-term debt, while counties funded less than 20% of such expenditures with long-term debt. Such debt can only be issued to carry out capital improvement or construction-related projects. If the Committee wants to encourage municipalities to finance transportation construction projects with cash, rather than debt, as described earlier in this paper, an adjustment or exclusion could be created for this purpose. The most recently available statewide expenditure data for municipalities is for 2015, which corresponds with the 2014(15) tax levy. Table 8 reports municipal maintenance and construction expenditure totals for the roads (expenditures performed on a contractual basis for work on the roads of other entities is not included). These amounts are primarily funded with tax levies, related assessments, intergovernmental revenue, and debt proceeds.

**TABLE 8**

**2014(15) Municipal Tax Levies and 2015 Street and Highway Maintenance and Construction Expenditures**

| | Amount (millions) | Percent of Levy |
|---|---|---|
| 2014(15) Tax Levy | $2,611.0 | |
| 2015 Local Highway & Street | | |
| - Maintenance | 562.3 | 21.5% |
| - Construction | 85.6 | 3.3 |
| Maintenance & Construction | $647.9 | 24.8% |

20. If the Committee wants to extend more flexibility under the levy limit but wants to limit the purpose for that authority to transportation projects, Alternative 4 would allow municipalities to increase their levies by an additional 0.5% for that purpose. In 2014(15), a 0.5% increase in levy authority would have permitted a 3.1% reduction in the amount of municipal long-term highway debt issued in 2015 for transportation-related construction expenditures by allowing those expenditures to be funded on a cash basis. To prevent the additional levy authority from being re-purposed in future years, an exclusion, rather than an adjustment could be authorized. This alternative might increase municipal levies on a statewide basis by $12.4 million in 2017(18) and $12.7 million in 2018(19), relative to the estimates under the Governor's proposal. Estimated tax bills would be higher by about $4 both in 2017(18) and in 2018(19).

**ALTERNATIVES**

The Committee may select more than one alternative.

1. Approve the Governor's recommendation to delete the current law provision that allows municipalities and counties to refrain from decreasing their allowable levies by the amount that their debt service on debt issued before July 1, 2005 decreases between the prior year and the current year.

2. Delete the Governor's recommendation to repeal the current law provision that allows municipalities and counties to refrain from decreasing their allowable levies by the amount that their debt service on debt issued before July 1, 2005 decreases between the prior year and the current year.

3. Authorize each municipality and county to increase its prior year levy by a minimum percentage if the net change in new construction is less than that percentage. Define the percentage as the average annual change in the CPI for all urban consumers as of September of each year, the same percentage used in the expenditure restraint program.

4. Create an exclusion to the levy limit by authorizing municipalities to levy an additional amount in any year for local transportation infrastructure construction projects. Limit the additional levy authority under this provision to no more than 0.5% of the prior year levy.

Prepared by: Rick Olin