Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

May 16, 2005 | Joint Committee on Finance | Paper #685

Levy Limit for Counties and Municipalities
(Shared Revenue and Tax Relief -- Property Taxation)

[LFB 2005-07 Budget Summary: Page 451, #1]

CURRENT LAW

Each county is subject to a tax rate limit on the general operations portion of its levy. For purposes of the control, each county's total tax levy and rate are separated into two components. The debt levy and debt levy rate are comprised of amounts for debt service on state trust fund loans, general obligation bonds, and long-term promissory notes, while the operating levy and operating rate are comprised of all other taxes. Each county's operating levy is limited to no more than an amount based on its prior year's allowable levy plus an adjustment equal to the percent change in the county's equalized value. For example, if a county's equalized value increases, or decreases, by 5%, its allowable levy will increase, or decrease, by 5%. Unless a county has claimed an adjustment to its levy, this mechanism has the effect of limiting each county's tax rate to the rate that was in effect in 1992(93), the year before the tax rate limit took effect.

Municipalities are not subject to a mandatory fiscal control. However, as a condition for receiving aid under the expenditure restraint program, municipalities must limit the year-to-year growth in their budgets to a percentage determined through a statutory formula. The statutes define municipal budget as the municipality's budget for its general fund exclusive of principal and interest payments on long-term debt. The percentage limitation on budgets equals the change in the consumer price index (CPI) plus an adjustment based on growth in the municipality's property value due to new construction.

GOVERNOR

Prohibit any city, village, town, or county from increasing its tax levy for purposes other than debt service by a percentage exceeding the sum of an inflation factor and a growth factor.

Define the inflation factor as a percentage equal to the average annual percentage change in the consumer price index for all urban consumers, U. S. city average, as determined by the U.S. Department of Labor, for the 12 months ending on June 30 of the year in which property tax bills are required to be mailed. Define the growth factor for counties as a percentage equal to 60% of the percentage change in the county's equalized value due to new construction, less improvements removed, as determined for January 1 equalized values in the year preceding the levy (a technical modification to the bill would clarify which year's value change is to be used), but not less than 0%. Define the growth factor for municipalities as a percentage equal to 60% of the percentage change in the equalized value due to new construction, less improvements removed, for the region in which the municipality is located as determined for January 1 equalized values in the year preceding the levy (a technical modification to the bill would clarify which year's value change is to be used), but not less than 0%. Define nine separate regions consisting of five to 10 geographically contiguous counties for purposes of calculating municipalities' growth factors and direct the Department of Revenue to assign each municipality to a region based on the county in which the municipality is located, as follows:

Region 1	Brown, Door, Florence, Kewaunee, Manitowoc, Marinette, Oconto, and Sheboygan counties;
Region 2	Calumet, Fond du Lac, Green Lake, Marquette, Menominee, Outagamie, Shawano, Waupaca, Waushara, and Winnebago counties;
Region 3	Buffalo, Crawford, Jackson, La Crosse, Monroe, Pepin, Pierce, Trempealeau, and Vernon counties;
Region 4	Adams, Forest, Juneau, Langlade, Lincoln, Marathon, Oneida, Portage, Vilas, and Wood counties;
Region 5	Ashland, Bayfield, Burnett, Douglas, Iron, Price, Rusk, Sawyer, Taylor, and Washburn counties;
Region 6	Columbia, Dane, Dodge, Jefferson, Rock, and Sauk counties;
Region 7	Kenosha, Milwaukee, Ozaukee, Racine, Walworth, Washington, and Waukesha counties;
Region 8	Grant, Green, Iowa, Lafayette, and Richland counties; and
Region 9	Barron, Chippewa, Clark, Dunn, Eau Claire, Polk, and Saint Croix counties.

Direct DOR to assign municipalities that are located in more than one county to the region containing the county that contains the greater amount of the municipality's taxable value.

Specify that the levy limit shall be adjusted, as determined by DOR, as follows: (a) if a municipality or county transfers to another governmental unit responsibility for providing any service that it provided in the preceding year, the levy increase limit otherwise applicable to the municipality or county is decreased to reflect the cost that the municipality or county would have incurred to provide the service; (b) if a municipality or county increases the services that it provides by adding responsibility for providing a service transferred to it from another governmental unit, the levy increase limit otherwise applicable to the municipality or county is increased to reflect the cost of providing that service; (c) if a city or village annexes property from a town, the annexing municipality's levy increase limit is increased by an amount equal to the municipality's mill rate applied to the current assessed value of the annexed territory and the levy increase limit for the town from which the property was annexed is decreased by the town's mill rate applied to the assessed value of the annexed territory as of the last year that the territory was subject to taxation by the town; and (d) if the county and municipal aid payment to a municipality or county is less than in the previous year, the levy increase limit is adjusted to reflect the reduction.

Specify that the levy limit does not apply to the following components of the levy of a municipality or county: (a) any tax increment levied by a city, village, or town; (b) amounts levied for the payment of any general obligation debt service, including debt service on debt issued or reissued to fund or refund outstanding obligations, interest on outstanding obligations, or the payment of related issuance costs or redemption premiums, secured by the full faith and credit of the municipality or county; (c) county levies for a county children with disabilities education board; and (d) levies by a first class city for school purposes.

Create a procedure under which a municipality or county may exceed its levy increase limit if the local government's governing body adopts a resolution to that effect and the electors of the municipality or county approve the resolution at a referendum. Require the resolution and referendum to specify the proposed amount of the levy increase above the limit. Authorize the local government to either call a special referendum or to hold a referendum at the same time as the next spring primary or election or September primary or November general election, provided that such an election is held no sooner than 42 days after the resolution is adopted.

Require the referendum question to be submitted to the electors as follows: "Under state law, the increase in the levy of the …. (name of county or municipality) for the tax to be imposed for the next fiscal year, …. (year), is limited to ….%, which results in a levy of $…. Shall the …. (name of the county or municipality) be allowed to exceed this limit and increase the levy for the next fiscal year, …. (year), by a total of ….%, which results in a levy of $….?". Specify that a town with a population below 2,000 may exceed its levy increase limit if the annual town meeting or a special town meeting adopts a resolution to that effect. Require the clerk of the municipality or county to publish notices regarding the referendum prior to the time it is held and to certify the results of the referendum or town resolution to DOR within 14 days of the referendum or meeting.

Direct DOR to administer the limit and authorize the Department to promulgate administrative rules relating to the reporting of debt service levies and nondebt service levies.

Sunset these provisions so that they do not apply to a property tax levy that is imposed after December, 2006.

DISCUSSION POINTS

Background

1. The 2003-05 Legislature included a levy limit proposal for counties and municipalities in Enrolled SB 44, the 2003-05 biennial budget bill. The Governor removed those provisions from the bill through partial veto, and a veto override attempt in the Senate was not successful. The vetoed provisions were incorporated into a separate bill, 2003 AB 466, which was adopted by the Assembly, but not taken up by the Senate. The 2003 proposal would have limited the rate of increase in the tax levy of each county and municipality to the jurisdiction's percentage change in tax base due to new construction, less improvements removed, as determined for equalized values as of January 1 in the year of the levy. The control would have applied for three years. The two proposals would have allowed several adjustments and exclusions to the limitation.

2. Earlier in the 2005-07 legislative session, the Legislature adopted AB 58 imposing fiscal controls on local governments. In addition to a levy limit for counties and municipalities, the bill included provisions affecting school districts, technical college districts, and the state forestry tax. The levy limit provisions for counties and municipalities were almost identical to those adopted in the 2003-05 legislative session. The Governor vetoed AB 58 on March 11, 2005, and the Assembly failed to override the veto on March 16, 2005.

3. The Governor's levy limit proposal in AB 100 is similar in many respects to the Legislature's proposal and, at the statewide level, both proposals would have a comparable impact on tax bills. Before vetoing AB 58, the Governor expressed reservations about the proposal regarding its lack of a state aid component. The Governor noted that his proposal is tied to "$100 million in incentives for local governments (counties and municipalities) that hold their levies even lower than what" would be allowed under the AB 100 levy limit provisions. A number of the Governor's objections focused on funding for primary and secondary education and were unrelated to counties and municipalities. The attachment to this paper provides a brief, side-by-side comparison of AB 58 and AB 100.

Arguments for a Fiscal Control

4. Fiscal controls have been proposed as a mechanism to address Wisconsin's property tax level, which ranks above-average relative to other states. In terms of state and local property taxes measured per $1,000 of personal income and per capita, Wisconsin maintained similar interstate rankings in 1995-96 and in 2001-02, although the rankings fluctuated somewhat on a year-to-year basis. Historically, Wisconsin's property tax amounts under each measure have exceeded the national average. Table 1 is based on data compiled by the U.S. Department of Commerce and is reproduced from the Legislative Fiscal Bureau informational paper entitled "State and Local Government Revenue and Expenditure Rankings" (#66).

TABLE 1

Wisconsin State and Local Property Taxes Per $1,000 of Personal Income and Per Capita

Year	Amount Per $1,000 of Pers. Inc.	Rank	% Above the U.S. Average	Amount Per Capita	Rank	% Above the U.S. Average
1995-96	$47.22	7	38.5%	$1,039.87	11	33.8%
1998-99	39.84	11	23.3	1,035.99	13	20.6
2001-02	40.76	8	27.3	1,188.63	13	22.6

5. Although statistics have not been compiled on a 50-state basis, data indicates that Wisconsin's property tax level has increased since 2001-02 under both measures. The Department of Commerce reports property taxes net of state property tax credits. Over the three intervening years, net property tax levies (for all classes of property) on a statewide basis have increased by 16.7%, averaging a 5.3% rate of increase each year. Over a comparable period, Wisconsin's personal income has increased by 11.5%, averaging 3.7% per year, and the state's population has increased by 2.5%, averaging 0.8% per year.

6. As growth in personal income has failed to keep pace with increases in property tax levies, concerns have been raised regarding changes in property tax bills outpacing taxpayers' ability to pay. Since 2001(02), the estimated tax bill on a median-valued home taxed at the statewide average tax rate has also increased at a faster rate than the change in inflation. From 2001 to 2004, the consumer price index for all urban consumers, U.S. city average, increased by 6.7%, and estimated property tax bills increased by 11.4%. Over the four years, the tax bill change averaged 3.7% annually, while the change in the inflation rate averaged 2.2% annually:

TABLE 2

Comparison of Change in Estimated Tax Bills on a Median-Valued Home Taxed at the Statewide Average Rate, Personal Income Growth, and the Inflation Rate

Year	Estimated Tax Bill	Percent Change	State Personal Income (Billions)	Percent Change	Consumer Price Index, 12-Month Average	Percent Change
2001(02)	$2,428		$158.89		177.07	
2002(03)	2,517	3.7%	162.87	2.5%	179.88	1.6%
2003(04)	2,587	2.8	167.98	3.1	183.96	2.3
2004(05)	2,706	4.6	177.15	5.5	188.88	2.7
Total Change		11.4%		11.5%		6.7%
Avg. Annual Rate of Change		3.7		3.7		2.2

7. The change in statewide gross property tax levies since 2001(02) has equaled 15.7% and averaged 5.0% annually, outpacing the inflation rate by a significant margin. Statewide increases among counties and municipalities both totaled 13.8% over the four-year period, although increases among school districts (17.5%) and technical college districts (15.5%) were higher. Among local governments, the highest rate of increase occurred for tax increment districts (19.1%), which reflects the substantial increases in taxable values that have occurred in those districts. Table 3 reports the year-to-year, total, and average rates of change in tax levies by type of jurisdiction for the 2001(02) to 2004(05) period. Tax levies for 2004(05) are based on preliminary data that may change slightly due to DOR audits.

TABLE 3

Change in Statewide Property Tax Levies by Type of Taxing Jurisdiction, 2001(02) to 2004(05)

	2001(02) to 2002(03)	2002(03) to 2003(04)	2003(04) to 2004(05)	Total Change	Average Annual Change
Schools	3.9%	5.5%	7.2%	17.5%	5.5%
Municipalities	4.8	3.1	5.2	13.8	4.4
Counties	5.0	3.6	4.6	13.8	4.4
Tech. Colleges	5.9	4.3	4.5	15.5	4.9
Special Districts	5.6	-0.7	4.4	9.5	3.1
Tax Inc. Districts	4.0	4.9	9.3	19.1	6.0
State Forestry Tax	7.3	7.6	8.4	25.2	7.8
Statewide Total	4.5%	4.4%	6.0%	15.7%	5.0%
Consumer Price Index	1.6	2.3	2.7	6.7	2.2

8. Over the last three years, county and municipal levy increases have substantially exceeded the inflation rate even though fiscal control programs have been in place. The county tax rate limit has been in effect since the 1993(94) tax year, and the expenditure restraint program has made payments since 1991 to certain municipalities that limit the year-to-year increase in their budgets. Not all municipalities qualify for expenditure restraint payments, and tax levy increases between 2001(02) and 2004(05) were lower for the 240 municipalities that received expenditure restraint aid both in 2002 and 2005 than for the 1,611 municipalities that did not. Among the latter group of municipalities, total levies increased by 18.7% over this period, as opposed to 12.0% for the expenditure restraint recipients. Although this experience indicates that the expenditure restraint program has constrained tax levy increases, those increases have substantially exceeded the inflation rate, nonetheless.

9. The consumer price index is the most commonly used measure of inflation, but it may not accurately reflect the cost increases experienced by local governments. The CPI is intended to reflect the cost of a "market basket" of goods purchased by typical households and is heavily

weighted toward the purchase of housing, transportation, and food and beverages. On the other hand, labor costs account for more than half of all local government spending and are not included as an expenditure category in the CPI. Thus, local government cost increases should not be expected to mirror changes in the CPI.

Arguments Against a Fiscal Control

10. Some have argued that it is unrealistic to expect county and municipal levies to have increased at a rate no greater than the inflation rate. Economic growth has occurred over the four-year period that has required local services to be extended to new properties. Since 2001(02), new construction has added 7.9% to the statewide property tax base. Over the same period, shared revenue and related aid payments to counties and municipalities have decreased. If these aid payments had increased at the same rate as inflation, 2005 payments would be higher by $29.7 million for counties and $116.1 million for municipalities. If counties and municipalities had increased their levies by corresponding amounts, tax levy increases of 2.1% for counties and 6.8% for municipalities would have occurred relative to 2001(02). If they had also levied to keep up with inflation (6.7%) and the change in tax base due to new construction (7.9%), tax levy changes of 16.7% for counties and 21.4% for municipalities would have occurred, compared to actual tax levy changes of 13.8% for both types of government.

11. Local officials are elected to make decisions to establish spending priorities and to determine appropriate taxation levels within their communities. A levy limit program would replace this discretion with a statewide policy that limits how much can be raised within each county and municipality. State and federal mandates may be responsible for a portion of the county and municipal levy increases displayed in Table 3.

12. Levy limitations have been characterized by some as unreasonable and arbitrary because local governments encounter situations that cause their levies to fluctuate from year-to-year. Some local governments may have responded to events last year that caused their 2004(05) levies to be abnormally high. Assuming those events do not recur, those local governments would have less difficulty complying with a limit in 2005(06). Other local governments may have taken actions that caused their 2004(05) levies to be abnormally low. Those local governments would have more difficulty complying with a limit in 2005(06). Fluctuations could occur for a variety of reasons, including the following:

- a local government applies surplus funds to reduce its levy in one year, thereby producing a low base levy when the succeeding year's levy limit is calculated;

- a local government uses cash to fund an item of capital equipment that might otherwise be funded on a multi-year basis with debt; or

- a local government incurs a one-time expenditure for an insurance or court settlement or for an emergency, natural disaster, or abnormal occurrence, such as heavy snowfall.

13. Levy limitations may have unintended effects. For example, local officials may supplant tax amounts with cash reserves or incur debt to fund expenditures that normally would be paid from current revenues. As a result, local officials may be unable to address emergencies or deal with unforeseen contingencies in a timely and efficient manner. Also, local officials may defer maintenance projects or capital expenditures. Such actions may reduce tax levies temporarily, but may be more costly to taxpayers over time.

Duration of the Fiscal Control

14. The levy limit proposed in AB 100 would apply for two years and the AB 58 proposal would be sunset after three years. Alternately, a levy limit could be imposed on a permanent basis. If the limitation's primary objective is property tax relief, a temporary control relies on local political pressure to limit tax increases after the control expires. At that time, deferred expenditure commitments and pent-up demands may result in tax increases that offset some or all of the tax relief that was achieved while the control was in effect. On the other hand, permanent controls may lose their efficacy over time. That was Wisconsin's experience between 1975 and 1982, when the state imposed a levy limit on counties and municipalities. The effect of that control was diminished over time as it was modified to address situations and events that were not initially anticipated. That experience may suggest that more tax relief might be achieved if a more restrictive control is enacted on a temporary basis. When the control expires, experience in the preceding years could be used to decide whether the limitation should be renewed, modified, or allowed to lapse. Conversely, if a permanent control is desired, it may be advisable to establish it at a level that is viewed to be sustainable, so that it does not need to be regularly loosened in the future.

15. The Governor would limit his proposal to two years because he maintains that the limitation should not extend beyond the state's aid commitment, which is budgeted biennially. The AB 58 proposal would extend for three years, and its expiration could be coordinated with the electorate's adoption or rejection of a constitutional amendment to impose permanent fiscal controls on local governments and the state.

Index for Limiting Tax Levies

16. The AB 100 proposal would allow each county and municipality to increase its levy by a percentage equal to the sum of an inflation factor and a growth factor. The inflation factor would equal the percentage change in the consumer price index for all urban consumers (CPI-U). The growth factor would equal 60% of the percentage change in tax base due to new construction. For municipalities, the growth factor would be calculated on a regional basis. For counties, the growth factor would be based on construction occurring within the county. Under AB 58, counties and municipalities would be allowed to increase their levies by a percentage equal to the change in their tax base due to new construction. The measures under both proposals would include a deduction for the taxable value of properties lost due to demolition, but neither proposal would allow the new construction percentage to be less than 0%. On a statewide basis, the AB 100 limitation would have allowed higher levy increases than the AB 58 limitation over the last four years.

TABLE 4

Statewide Allowable Levy Increases Under Two Controls, 2001 - 2004

	AB 58, Single Factor:	AB 100, Two-Factor:		
	New Construction	Growth (60%)	Inflation	Combined
2001	2.7%	1.6%	3.4%	5.0%
2002	2.5	1.5	1.8	3.3
2003	2.5	1.5	2.2	3.7
2004	2.6	1.6	2.2	3.8

17. The CPI-U is the most common measure of inflation and is based on changes in the price of food, clothing, shelter and fuels, transportation fares, charges for doctors' and dentists' services, drugs, and other goods and services that people routinely buy for personal use. The index is updated monthly. AB 100's use of the CPI-U guarantees some increase to all counties and municipalities and would allow increased levies to assist in the continuation of current service levels.

18. Using the percentage of tax base change due to new construction as a basis for allowing levy increases would target tax levy increases to areas experiencing economic expansion. AB 100 would recognize only 60% of the percentage change. The budget test under the expenditure restraint program has been based on 60% of the new construction percentage since 1994. The rationale for using 60%, as opposed to 100%, is to distinguish between fixed and variable costs, since not all public service costs are impacted by new development. AB 58's exclusive use of this measure implies that levy increases are necessary only to extend services to new properties and that local governments possess sufficient resources to continue providing services to existing taxpayers. To the extent that inflation increases the cost of services, AB 58 would require local governments to either find efficiencies in their service delivery, reduce service levels, or use other revenue sources to fund those services.

19. Considerable variation exists in the distribution of new construction activity throughout the state. If AB 58 had been in effect for 2004(05), 58 municipalities would not have been allowed any levy increase, and an additional 312 municipalities would have been allowed increases of less than 1.0%. The percentage change in tax base due to new construction between 2003 and 2004 ranged from 1.2% to 5.9% for the state's 72 counties and from -7.0% to 19.4% for the state's 1,850 municipalities. Based on 2003 construction activity, Table 5 reports the distribution of counties and municipalities by quintile.

TABLE 5

2003 to 2004 Distribution of Tax Base Change Due to New Construction

	County Range in Tax Base Change	Municipal Range in Tax Base Change
First 20%	1.2% to 1.5%	-7.0% to 1.0%
Second 20%	1.6% to 1.9%	1.0% to 1.6%
Third 20%	1.9% to 2.3%	1.6% to 2.3%
Fourth 20%	2.3% to 2.8%	2.3% to 3.4%
Fifth 20%	2.8% to 5.9%	3.4% to 19.4%

20. Under AB 100, the new construction percentages would be calculated on a regional basis, and the variation in these percentages would be reduced, relative to those in AB 58. Among the nine regions delineated in the Governor's proposal, the new construction percentages for 2003 to 2004 would have ranged from 1.7% to 3.7%, and 60% of these amounts would have ranged from 1.0% to 2.2%. In combination with the actual inflation rate from July, 2003, through June, 2004, this would have given each municipality in the state at least a 3.2% allowable levy increase.

TABLE 6

2004(05) Allowable Levy Increases for Municipalities If AB 100 Had Been in Effect and Based on the Actual Changes in CPI and Tax Base

	2003-04 Tax Base Change Due to New Construction	Proposed Growth Factor (60% of Prior Column)	Levy Limit Percentage
Region 1	2.8%	1.7%	3.9%
Region 2	2.9	1.8	4.0
Region 3	2.5	1.5	3.7
Region 4	1.9	1.2	3.4
Region 5	1.7	1.0	3.2
Region 6	3.4	2.1	4.3
Region 7	2.2	1.3	3.5
Region 8	2.5	1.5	3.7
Region 9	3.7	2.2	4.4

21. The Governor has indicated that calculating the growth factor on a regional basis is intended to encourage municipalities to "work together to promote economic development." While that effect may occur, it should be noted that the location of most new development is not likely to

significantly increase costs for other municipalities in the same region, particularly given the geographic size of the proposed regions. Also, using a regional calculation may not allow municipalities experiencing new construction to be able to raise their levies by an amount sufficient to fully fund the services for the newly-constructed properties. Finally, any impact on regional cooperation would be limited since all of the new construction for calculating the December, 2005, allowable levy has already occurred and over one-half of that for calculating the December, 2006, allowable levy will have occurred by the time the budget bill is enacted.

22. AB 100 designates the nine regions based on regional planning commission boundaries. An exception would be made for Dane County municipalities, which are members of the Dane County Regional Planning Commission, and the municipalities in the five surrounding counties that are not affiliated with a regional planning commission. Municipalities from the six counties would be included in a single region. Regions could be based on other concepts. For example, each county could comprise a region for its underlying municipalities. This would result in more variation in new construction percentages, relative to AB 100. Alternately, regions could be defined on the basis of metropolitan statistical areas (MSA). The U.S. Office of Management and Budget defines an MSA as a county or group of counties with a total population of at least 100,000. The area must also contain at least one city with a population of 50,000 or more. Outlying counties are included within a MSA based on their population densities and the volume of commuting to central counties. Wisconsin contains 13 MSA's, including two where the central county is located in Minnesota, and they encompass 25 counties. If regions are defined on this basis, municipalities in the state's remaining 47 counties could be included in a single region. Some of these counties have low percentages of tax base growth due to new construction. By combining them in a larger group, they could realize higher rates of levy increase, although other counties would then have lower rates.

23. Tax increases could also be tied to other measures. For example, if the measure is intended to reflect the change in taxpayers' ability to pay for government services, the year-to-year change in Wisconsin personal income could be used. Under that measure, the share of income used to support county and municipal levies would be held constant in future years (if set at 100% of personal income growth) or could be forced to decrease (if set at less than 100% of personal income growth). In addition to inflation, the percent change in Wisconsin personal income also reflects growth due to higher productivity and population increases. The measure is published quarterly and is subject to retroactive revisions. Statistics for each quarter are released near the end of the succeeding quarter. Over the last four years, Wisconsin's personal income has increased by 2.5% (2001-02), 3.1% (2002-03), and 5.5% (2003-04). A drawback in using personal income growth for a levy limit may relate to accessing that data on a timely basis. Although personal income for the state as a whole is known shortly after the close of each year, amounts for individual counties are not known for more than 12 months after the year's close, and amounts are not tabulated for individual municipalities.

Exclusions from the Limitation

24. Under both AB 58 and AB 100, the base for calculating future levy increases would

be the levy in the year preceding enactment of the limit. Presumably, this would be the 2004(05) levy. Regardless of the proposal, the designation of a base year is arbitrary and may be criticized as being unfair to some local governments. Due to occurrences such as the application of surplus funds, some governments will possess atypically low base year levies. Other occurrences, such as one-time expenditures, will cause other governments to have atypically high base year levies. If there is a desire to address these types of contingencies, the base year levy could be modified to reflect one of the following options:

- if a local government increases the reserves applied to its budget for the base year relative to the reserves, if any, applied in the previous year, the government's base year levy could be increased by the amount of the increase in reserves applied; or

- if a local government's base year levy is lower than its levy from the prior year, the government could be allowed to use either the higher of the two amounts or the average of the two amounts as its base year levy.

25. Once a limit is enacted, local governments that do not levy the full amount allowable under the limit might raise a criticism by claiming that the limit penalizes their restraint. Meanwhile, local governments that levy to their allowable limit are allowed a higher base year levy in the succeeding year. This criticism could be addressed by permitting local governments to carry forward all or a portion of their unused allowable increase to the next year. This modification may be more necessary if a limit is proposed on a permanent basis.

26. Both AB 100 and AB 58 would exclude from the control the tax levies made by counties for county children with disabilities education boards and by first class cities for school purposes. In addition, the tax increment generated by a tax increment financing district would not be treated as part of the municipal levy.

27. Fiscal controls typically contain provisions regarding special treatment of debt and debt service. This reflects that local governments pledge an irrepealable tax, backed by their full faith and credit, to repay general obligation debt. Without some form of exclusion or adjustment, the control could constrain local governments' ability to fulfill this pledge. Bond lawyers and rating agencies may respond negatively, resulting in lower credit ratings and higher borrowing costs.

28. AB 100 would exclude from the limit any amounts needed to pay debt service on general obligation debt. The Department of Administration has indicated that this provision should be revised to clarify that only "new" debt, and not existing debt, would be excluded when determining the base for calculating allowable increases. For debt authorized before July 1, 2005, AB 58 would exclude any increase in the amount needed for debt service from the limitation. For general obligation debt authorized on or after July 1, 2005, that is approved through referendum, AB 58 would exclude all related debt service from the limitation. The practical effect of the AB 58 provisions would likely be to require a referendum for all debt authorized on or after July 1, 2005. Other possible debt exclusion provisions may include debt authorized by a supermajority vote of the governing body or new debt issuance that does not exceed the average, annual amount issued over a

specified number of previous years.

Adjustments

29. AB 58's treatment of debt service may be more comparable to an adjustment to the levy than to an exclusion. Adjustments to fiscal controls are generally included as mechanisms for providing additional flexibility to local governments experiencing specific sets of circumstances. AB 100 would provide for adjustments to the allowable levy to reflect:

- the cost of services transferred to the county or municipality from another government (this adjustment would increase the allowable levy of the county or municipality);

- the cost of services transferred by the county or municipality to another government (this adjustment would decrease the allowable levy of the county or municipality);

- the taxes a town levied on territory annexed by a city or village when the territory was last taxed by the town (this adjustment would decrease the allowable levy of the town);

- the taxes a city or village would have levied on territory it has annexed, calculated by multiplying the prior year tax rate of the city or village by the city's or village's assessed value of the territory (this adjustment would increase the allowable levy of the city or village); and

- any reduction in state aid payments under the county and municipal aid program from the previous year (this adjustment would increase the allowable levy of the county or municipality).

AB 58 would not provide an adjustment for state aid reductions, but would extend similarly structured adjustments to the other adjustments listed above, although the allowable increase for a city or village annexing property would be based on the town taxes levied on the property in the previous year.

30. The proposed service transfer adjustment under both proposals may not have the intended effect in certain instances. In the past, DOR has determined that the portion of a county's tax levy that is not uniformly extended over the entire county is not subject to the county tax rate limit. This interpretation could be extended to the levy limit proposal, as well. For example, if a county is providing public health services over a portion of the county in one year and consolidates the public health function in the succeeding year by extending public health services within the municipalities that previously performed those services, the county's levy for public health services would be included in the county levy in the latter year, but would not be included in the base year. This treatment would discourage public service transfers contrary to the intent of the service transfer adjustment. This situation could be remedied by providing a base adjustment for such service consolidations.

31. Adjustments can erode the effectiveness of fiscal controls over time. Unique circumstances may lead to requests for other adjustments to reflect events such as natural disasters,

court orders, emergencies, collective bargaining agreements, federal or state mandates, or population changes. Although each individual adjustment may have merit, their cumulative effect could allow levy increases well above the overall target percentage increase. Generally, AB 100 and AB 58 would extend adjustments only to events where a negative adjustment would offset each positive adjustment. An exception is the state aid adjustment proposed in AB 100. Based on the state aid provisions in AB 100, a state aid adjustment is not necessary because the bill would not result in county and municipal aid payment changes during the two years that the limitation would be in effect. Changes to the duration of a limit and state aid policy may make such a provision more important.

32. Both AB 100 and AB 58 would permit counties and municipalities to exceed their allowable limit if approved through referendum. Levy limitations are often characterized as undermining local autonomy because levies are determined through a state-mandated formula rather than by locally-elected officials. By allowing the limitation to be overridden through referendum, the proposals retain local autonomy, although through a vote of the electorate rather than a vote of the elected. If there is a desire for a greater level of control by locally-elected officials, additional levy increases could be allowed if adopted by either two-thirds or three-fourths of the members-elect of the local governing body.

33. The referendum provisions in the two bills are almost identical. However, AB 58 would require referenda to specify whether the additional increase is to apply to a single year or on an ongoing basis. Also, AB 100 would permit referenda to be called at special elections in either year. AB 58 would limit special referenda to the 2005 and 2007 levies and would require referenda related to the 2006 levy to be held in the spring primary or election or the September primary or general election.

34. Both AB 100 and AB 58 would waive the referendum provisions for towns with populations below 2,000 and would permit those towns to exceed their limitation if approved at the annual town meeting or a special town meeting (in 2004, this would have applied to 1,065 of the state's 1,260 towns). Since each elector may vote at those meetings, they may be viewed as being comparable to a referendum. However, unlike a referendum, where a specific question is proposed by the town board, the bills do not require town board approval of a question to be presented to the town meeting. Current law authorizes the electors of the town, convened at the town's annual meeting, to levy taxes or delegate the power to levy taxes to the town board. A special town meeting, possessing powers identical to those of the annual town meeting, may be called by the town meeting, by the town board, or by the electors of the town. A class two notice must precede a special town meeting.

Miscellaneous

35. Neither AB 100 nor AB 58 contain provisions specifying an enforcement mechanism for counties and municipalities that exceed their allowable limitation. Thus, the proposals would rely on taxpayers to enforce the limitation through court action. Another option would be to require DOR to enforce the limitation, as one of its administrative responsibilities.

36. Both the school revenue limit and county tax rate limit programs require the administering state agency to enforce the limit and authorize penalties against local governments exceeding their limit. If a school district exceeds its maximum allowable revenue without referendum approval, the Department of Public Instruction must reduce the district's state equalization aid payment by the excess revenue amount. The penalty is imposed in the same school year in which the district raised the excess revenue. If a county exceeds its operating levy rate under the county tax rate program, DOR is required to reduce the county's shared revenue payment by the amount of the excess. If the excess exceeds the county's shared revenue payment, the county's transportation aid payment is reduced by the remaining amount.

37. Both AB 100 and AB 58 contain provisions affecting other components of the property tax bill. AB 100 would increase the state's share of partial school revenues over a two-year period and modify school revenue limits. AB 58 would impose a three-year levy limit on technical college districts, permitting annual levy increases of 2.6% for each district, and would also limit increases in the state forestry tax to 2.6% per year. AB 58 contains a provision that would require the Joint Committee on Finance version of the 2005-07 biennial budget to include some combination of general school aids funding and revenue limits sufficient to result in an estimated school property tax levy in 2005-06 and 2006-07 that would be no greater than the amount levied in 2004-05.

38. The property tax provisions proposed in AB 100 and AB 58 would have secondary fiscal effects on other state programs. AB 100 reflects reduced GPR expenditure levels in three property tax relief programs, as follows: (a) -$2,100,000 in 2005-06 and -$4,100,000 in 2006-07 for computer aid payments; (b) -$1,300,000 in 2005-06 and -$2,800,000 in 2006-07 for the homestead tax credit; and (c) -$300,000 in 2005-06 and -$800,000 in 2006-07 for the farmland preservation credit. In addition, state income tax collections would increase by an estimated $3,800,000 in 2005-06 and $8,700,000 in 2006-07 due to reduced property tax/rent credits. Removing the fiscal control and state aid provisions from AB 100 would reverse these effects, and modifying the provisions would require revisions to these secondary fiscal effects.

ALTERNATIVES

The following material offers an outline for structuring a levy limitation based on the issues discussed in the preceding material.

Base for Calculating the Limitation

The base for calculating the limitation would be the tax levy in the previous year:

- Plus any increase in surplus funds applied to reduce the levy between the year preceding the levy and the year preceding that year;
- Plus either 50% or 100% of any reduction in the levy from the year preceding the previous year compared to the previous year;
- Plus the difference between the allowable levy in the preceding year and the actual

levy in the preceding year multiplied by
- 100%;
- 50%; or
- 33%.

- Exclusive of amounts levied for
  - county children with disabilities education boards;
  - tax increment districts (tax increments);
  - school purposes, if levied by a city of the first class;
  - debt service on:
    a. all general obligation debt;
    b. debt authorized prior to July 1, 2005;
    c. debt approved through referendum;
    d. debt approved by either a two-thirds or three-fourths vote of the governing body; and/or
    e. debt that does not exceed the average debt issuance for a specified number of previous years.

Duration of Control

- Sunset after two years;
- Sunset after three years; or
- Permanent.

Index for Limitation

- Percentage change in the consumer price index for all urban consumers (CPI-U);
- 100% of the percentage change in tax base due to new construction;
- 60% of the percentage change in tax base due to new construction;
- A specified percentage of the percentage change in the state's personal income; or
- A combination of the preceding factors.

Geographic Basis for Calculating the New Construction Percentages for Municipalities

- Municipal;
- County;
- Regional
  - based on regional planning commission boundaries; or
  - based on the delineation of metropolitan statistical areas.

Adjustments

- Service transfers;
- Service consolidations (especially as they pertain to countywide levies);
- Annexations;
- County and municipal aid reductions;
- Amounts approved through referendum; and/or
- Amounts approved at annual or special town meetings, if the town has a population under 2,000.

Referenda

Allow referenda to override the limitation if approved through a:

- Special election;
- Special election only in odd-numbered years; and/or
- Spring primaries or elections or September primaries or general elections in even-numbered years.

Penalty

- No provision; allow taxpayers to enforce the limitation through court action; or
- Require DOR to enforce the limitation by reducing the county and municipal aid payment for any county or municipality exceeding the limitation by the amount of the excess; specify that any aid reduction would lapse to the state's general fund.

Prepared by: Rick Olin
Attachment

ATTACHMENT

Comparison of County and Municipal Fiscal Control Provisions in AB 58 and AB 100

Fiscal Control	Limit the rate of increase in the property tax levy of each county and municipality	
	AB 58, as adopted by the Legislature	AB 100, Governor's biennial budget
Allowable Percentage		
- Municipalities	the percentage change in the municipality's equalized value due to new construction, less improvements removed	the sum of two factors: - average annual percentage change in the U.S. consumer price index, for all urban consumers, U.S. city average for the 12 months ending on June 30 of the year of the levy - 60% of the percentage change in the region's equalized value due to new construction, less improvements removed
- Counties	the percentage change in the county's equalized value due to new construction, less improvements removed	the sum of two factors: - average annual percentage change in the U.S. consumer price index, for all urban consumers, U.S. city average for the 12 months ending on June 30 of the year of the levy - 60% of the percentage change in the county's equalized value due to new construction, less improvements removed
Adjustments	- service transfers - annexations - referenda - annual or special town meetings	- service transfers - annexations - referenda - annual or special town meetings - county and municipal aid reductions

	AB 58, as adopted by the Legislature	AB 100, Governor's biennial budget
Exclusions	- amounts levied for a county children with disabilities education board - amount that a first class city levies for school purposes - tax increments - amounts levied for the payment of any general obligation debt service approved by resolution adopted before July 1, 2005, or by referendum on or after July 1, 2005	- amounts levied for a county children with disabilities education board - amount that a first class city levies for school purposes - tax increments - amounts levied for the payment of any general obligation debt service
Sunset	three years after effective date - would apply to tax levies in 2005, 2006, and 2007	after December, 2006 - would apply to tax levies in 2005 and 2006
Levy Restraint Aid		
- Municipalities	No provision	municipalities with local purpose tax rates above five mills that limit the increase in their levies to 85% of the amount calculated under the preceding provisions* would qualify for state aid totaling $68 million annually
- Counties	No provision	counties that limit the increase in their levies to 85% of the amount calculated under the preceding provisions* would qualify for state aid totaling $35 million annually *except that the new construction adjustment would be limited to 2%, before applying the 85% provision