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County Levy Restraint Program
(Shared Revenue and Tax Relief -- Direct Aid Payments)

Bill Agency

[LFB 2005-07 Budget Summary: Page 503, #5]

CURRENT LAW

2005 Wisconsin Act 25 imposed a levy limit for the 2005(06) and 2006(07) property tax years on counties and municipalities. The Act prohibited any county or municipality from increasing its total levy in either of the two years 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 two percent. Increases above the limit could be approved through the passage of a referendum. Act 25 sunset the limit on January 1, 2007.

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.

GOVERNOR

Create a county levy restraint program and create two sum sufficient appropriations to make state aid payments to eligible counties. Set the distribution level for the county levy restraint payment account appropriation at $15,000,000 annually, beginning in 2009. Set the distribution level for the county levy restraint bonus payment account appropriation at $10,000,000 annually, beginning in 2009. Require the payments for each year's distribution to be made on the fourth Monday in July.

Provide payments from the two appropriations to counties if in the year that is two years before the aid payment, the county has a county tax levy that is no greater than the county's maximum allowable levy, as defined under this program. (The bill's language should be clarified to achieve this intent.)

Define county tax levy as the sum for all municipalities in the county of the amounts reported as total county taxes levied, as reported on the statement of taxes filed with the Department of Revenue, but excluding any taxes levied for a county children with disabilities education board. Provide that a county's tax levy, for purposes of determining eligibility and computing aid payments, be adjusted based on the following conditions: (a) if a county transfers to another governmental unit responsibility for providing any service that it provided in the preceding year, the county's tax levy for the preceding year would be decreased to reflect the amount that the county levied to provide the service; and (b) if a county increases the services that it provides by adding responsibility for providing a service transferred to it from another governmental unit in any year, the county's tax levy for the preceding year would be increased to reflect the cost of providing that service. Define county tax rate as the county's tax levy divided by its equalized value, as determined under current law, excluding the tax increments in any tax incremental financing districts (the intent was to refer to value increments).

Define maximum allowable levy as the county's tax levy in the year two years before the aid payment increased by a percentage equal to 85% of the sum of two percentages, based on inflation and valuation growth, rounded to the nearest 0.01%.

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 that is two years before the year of the aid payment. Define the valuation factor as a percentage equal to 60% of the percentage change in the county's equalized value due to new construction, less improvements removed, between the year two years before the year of the payment and the previous year, but not less than 0% nor greater than 2%.

Specify that the maximum allowable levy does not apply to amounts levied for the payment of any general obligation debt service, secured by the full faith and credit of the county, 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. Provide that if the county and municipal aid payment to a county is less than in the previous year, the county's maximum allowable levy would be increased to reflect the reduction.

Calculate each eligible county's payment from the county levy restraint payment account appropriation by: (a) dividing the county tax levy for the county by the sum of all such amounts for all eligible counties; and (b) multiplying the resulting percentage by $25,000,000. (This amount should be changed to $15,000,000 to agree with another provision in the bill and with the Governor's Executive Budget Book.)

Calculate each eligible county's payment from the county levy restraint bonus payment account appropriation by: (a) subtracting the county's tax levy from its maximum allowable levy; (b) dividing that amount by the sum of all such amounts for all eligible counties; and (c) multiplying the resulting percentage by $10,000,000.

Direct DOR to administer the program by calculating payments, by notifying eligible counties of their estimated payment amounts in the year preceding the aid payment, by certifying to the Joint Committee on Finance, on August 1 of each year, the appropriate percentage change in the consumer price index that is to be used to determine the inflation factor, and by making adjustments to levies to reflect service transfers.

Because this program's first aid payments would occur in July, 2009, which is in the 2009-11 biennium, the proposal would have no direct fiscal effect in the 2007-09 biennium. However, by limiting county property tax increases in 2007(08) and 2008(09), the 2007-09 funding levels for the computer aid, homestead tax credit, farmland preservation credit, and property tax/rent credit programs would be indirectly affected.

DISCUSSION POINTS

1. Fiscal controls, such as the one proposed under these provisions, are a mechanism to reduce Wisconsin's property tax level, which ranks above-average relative to other states. For 2003-04 (the most recent year compiled by the U.S. Department of Commerce), Wisconsin's level of state and local property taxes per $1,000 of personal income exceeded the national average by 26.9%, and Wisconsin's per capita level of state and local property taxes exceeded the national average by 24.6%. Since 2001-02, the estimated property tax bill for the typical homeowner has increased faster than the rate of inflation, as have gross property tax levies. These observations are discussed more fully in the Legislative Fiscal Bureau issue paper entitled "Levy Limit for Counties and Municipalities" (Paper #725).

2. Local officials cite a number of factors as the cause for property tax increases. They view the state as partially responsible for the increases because the state has imposed mandates on local governments and funding for state aid has not kept pace with inflation. Mandates related to the courts, youth aids, probation and parole, and human services have been cited as particularly

significant relative to their impact on county expenditures. In April, 2005, most counties held advisory referenda regarding mandates in the areas of human services and the courts. The Wisconsin Counties Association reports that state funding for these mandates was supported by 85% of the participating voters in 69 of the state's 72 counties. Some county officials view the imposition of fiscal controls as inconsistent with state mandates because local officials are being asked to limit costs that are beyond their control. They often object to state-imposed local fiscal controls as state interference in the local decision-making process and view themselves as better able than the state to evaluate the need for public services in their counties and their taxpayers' ability to pay for those services. In its "2007-08 Legislative Agenda," the Wisconsin Counties Association lists seven "broad policy initiatives" including one to "oppose artificial expenditure/revenue caps which limit local control."

3. SB 40 proposes both a levy limit for counties and a levy restraint program that would provide aid to counties that adhere to a fiscal control similar to the proposed levy limit. By linking local fiscal controls with state aid payments, local governments can decide to forego the state aid. In this way, state policy objectives can be balanced against the goal of local control. This balancing can be affected by the amount of aid at risk and the other policy objectives associated with the aid payment. Linking a new aid payment to a desired behavior creates a positive incentive to adjust the desired behavior.

4. Because the $25 million in additional funding would be paid in July, 2009, the expenditure would occur in the 2009-11 biennium and represents an advance commitment. When combined with increases in other tax relief appropriations proposed in SB 40, advance commitments in the "shared revenue and tax relief" portion of the budget total $130 million. This implies that the "first" $130 million in revenue growth in the 2009-11 biennium would be used to fund these increases. As an example, the Legislative Fiscal Bureau's January 30, 2007, memorandum on general fund revenue and expenditure projections indicates that general fund revenues are estimated to increase by $397.9 million in the first year of the 2007-09 biennium under current law provisions. Assuming similar revenue growth in the first year of the 2009-11 biennium, the $130 million increase would use 33% of the additional revenues. The $25 million increase under the levy restraint program would use just over 6% of the additional revenues.

5. The levy limit proposed under the county levy restraint program differs from the levy limit that SB 40 proposes for all counties in several ways. First, the base levy from which allowable increases would be calculated would be the prior year's allowable levy under the levy limit proposal, as opposed to the prior year's actual levy under the levy restraint proposal. Second, the allowable percentage increase would be equal to the greater of 4% or the percentage change in the county's tax base due to net new construction under the levy limit proposal, as opposed to 85% of the sum of two percentages under the levy restraint proposal. The first percentage would be equal to 60% of the percentage change in the county's tax base due to net new construction, but not less than 0% nor more than 2%. The second percentage would be equal to the 12-month change in the consumer price index. Third, adjustments would be allowed for service transfers and consolidations and for increases in debt service for debt authorized before July 1, 2005, under the levy limit proposal, as opposed to service transfers and reductions in county and municipal aid payments

under the levy restraint proposal. Finally, exclusions from the control would be allowed for amounts levied for county children with disabilities education boards, town bridge and culvert construction and repair, debt service on debt authorized after July 1, 2005, and debt service on appropriation bonds related to a county's employee retirement system liability (removed from the bill as a non-fiscal policy item) under the levy limit proposal, as opposed to amounts levied for county children with disabilities education boards and debt service on any general obligation debt under the levy restraint proposal.

6. These differences between the two proposed fiscal controls may violate the principle of administrative simplicity, which suggests that individuals are most likely to modify their behavior if there are understandable rules and predictable consequences. Therefore, imposing multiple fiscal controls and distribution formulas may not have the desired effect on local decisions. If the Committee decides to authorize an additional fiscal control for counties, the Committee could use the levy limit provisions it adopted in executive action on May 3, 2007, as the eligibility test for the aid payment to avoid having two tests. If it is determined that a more restrictive control should apply to the incentive program, a percentage of the allowable increase under the levy limit could be used.

7. Prior to 2005 Act 25's creation of a levy limit program, county property tax levies had increased at an average annual rate of 5.25% between 2000(01) and 2004(05). Under the levy limit program, county levies increased on a statewide basis by 3.46% in 2005(06) and 3.16% in 2006(07). Over the same period, allowable rates of increase under the proposed levy restraint program would have equaled 3.86% in 2005(06) and 4.63% in 2006(07). The proposed program's higher rates of allowable increase are due to its inclusion of inflation measures that were high relative to prior years. Measured on a fiscal year basis, the annual increase in the CPI between 1999-00 and 2003-04 averaged 2.39%. The comparable measures increased to 3.01% for 2004-05 and to 3.81% for 2005-06. Lower inflation rates are forecast for 2007 through 2010.

8. An alternative to the bill that would not require additional funding in 2009-11 would be to link SB 40's levy limit proposal to the county and municipal aid program. This action would reduce the bill's advance commitment of expenditures for 2009-10 by $25 million. Currently, the county and municipal aid program provides $157.2 million annually in unrestricted state aid payments to counties, and all counties receive a payment. However, linking existing aid, especially if it is substantial, to a desired behavior creates a situation that may be viewed more as a penalty for not engaging in the behavior, rather than as a reward for engaging in the behavior. Instead, counties could forfeit an aid amount equal to all, or part of the levy or spending in excess of the allowable limitation. If an amount equal to all of the excess is withheld, there would be no advantage in exceeding the limitation. This is the enforcement mechanism used in the proposed levy limit program.

9. Rather than employing a fiscal control based on tax levies, a control could be designed that would limit increases in spending. An expenditure control tied to a state aid payment has been authorized for municipalities since 1991. Under the expenditure restraint program, municipalities with municipal purpose tax rates above five mills receive an aid payment if they

restrict the rate of year-to-year growth in their budgets to a percentage determined by 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. Adjustments to the budgeted amounts are allowed for service transfers, state recycling tipping fees, and revenue sharing agreements. For the year prior to the aid payment, the rate of budget growth cannot exceed the inflation rate plus an adjustment based on growth in municipal property values.

10. A fiscal control based on spending, such as under the expenditure restraint program, will have different impacts than a control based on taxes. A control with a focus on spending implies a policy objective of limiting the size or scope of government. A control with a focus on taxes implies a policy objective of reducing local governments' reliance on the property tax. A fiscal control will achieve a greater level of effectiveness if it is designed on the basis of a clearly articulated public policy objective.

11. Intergovernmental revenue, such as state aid, is one reason that different types of fiscal controls have different impacts on individual local governments. The most recent year for which the Department of Revenue has tabulated local revenue and expenditure data is 2005. Using that data, Table 1 shows the distribution of counties based on the percentage of their general expenditures within the governmental funds category funded with intergovernmental revenue. On average, intergovernmental revenue funded 38.5% of county expenditures. However, intergovernmental revenue funded less than 30% of expenditures for 12 counties, and more than 40% of expenditures for 32 counties.

TABLE 1

Intergovernmental Revenue as a Percent of County General Expenditures Within the Governmental Funds Category, 2005

	Number	Percent
Under 20%	1	1.4%
20% to 30%	11	15.3
30% to 40%	28	38.9
40% to 50%	28	38.9
50% to 60%	4	5.5
Total	72	100.0%

12. Based on the 2005 financial information, Tables 2 and 3 relate the variation in intergovernmental revenue reliance to the impact resulting from the two types of fiscal controls. Table 2 illustrates the potential impact of a 3% across-the-board increase in tax levies on county spending, assuming no other increases in the counties' revenue sources. A 3% levy control would have limited spending increases (unless fees or other non-levy revenues were raised) to less than 1.25% for 58 counties. No county would have been able to increase spending by more than 1.75%, and only three counties would have been able to increase spending by 1.50% to 1.75%.

TABLE 2

**Distribution of General Expenditure Increases*
Under a 3% Across-the-Board Levy Limit
Based on 2005 Financial Information**

	Number	Percent
0.50% to 0.75%	4	5.5%
0.75% to 1.00%	18	25.0
1.00% to 1.25%	36	50.0
1.25% to 1.50%	11	15.3
1.50% to 1.75%	3	4.2
Total	72	100.0%

*Prior to any increase in nonproperty tax revenues.

13. Table 3 illustrates the potential impact of a 3% across-the-board increase in expenditures on county property tax levies, assuming no other increases in counties' revenue sources. To achieve the allowable expenditure level, levy increases of more than 7.0% would have been allowed in 60 counties.

TABLE 3

**Distribution of Potential County Tax Levy Increases*
Under a 3% Across-the-Board Expenditure Limit
Based on 2005 Financial Information**

	Number	Percent
Under 7.0%	12	16.7%
7.0% to 8.0%	19	26.4
8.0% to 9.0%	19	26.4
9.0% to 11.0%	12	16.7
Over 11.0%	10	13.8
Total	72	100.0%

*With no increase in nonproperty tax revenues.

14. The preceding analysis indicates that, due to variation in the percentage of expenditures funded by intergovernmental revenue, a levy limit may offer more restrictive expenditure increases than anticipated and an expenditure control may allow larger increases in

levies than anticipated. Nonetheless, it should be acknowledged that taxing and spending levels are related and controlling one will also control the other, to some degree. In addition, the two controls will have other secondary impacts. For example, a property tax control would likely cause some counties to make use of other revenue sources, such as fees. Likewise, a spending control could lead to some counties reclassifying certain operating expenditures as capital assets to be funded with debt.

15. Because fiscal controls will likely trigger behavioral responses by local officials, the design of a control should balance effectiveness against flexibility. Exclusions and adjustments to a control may make it more flexible, but the control will also be less likely to meet its intended policy objectives. If the control offers few exclusions or adjustments, it may be viewed as inflexible, and local officials may be able to persuade taxpayers to override the control or legislators to amend the control. In SB 40, the proposed county levy restraint program's fiscal control would offer adjustments for service transfers and state aid reductions and exclusions for amounts levied for county children with disabilities education boards and general obligation debt service. A number of other adjustments could be provided for other occurrences, such as service consolidations, town bridge and culvert construction and repair, payments to an adjacent county for library services, debt service on appropriation bonds related to a county's employee retirement system liability, or amounts approved through referendum (all included under SB 40's levy limit) or for an unusually low base year levy, natural disasters, emergencies, or court orders (not included under SB 40's levy limit either).

16. Each of the preceding adjustments and exclusions may appear to be reasonable when evaluated alone, but in combination, they could undermine the effectiveness of the fiscal control. Unlike SB 40's levy limit proposal, which would be sunset after two years, the county levy restraint program is intended to be ongoing. This heightens the importance of balancing the program's flexibility with its effectiveness.

17. Depending on the number of adjustments or exclusions that are authorized, the program's allowable rate of increase could be adjusted in a way that achieves the desired level of effectiveness. Fiscal controls utilize an allowable rate of increase, typically expressed in percentage terms, to be applied against a local government's tax levy or expenditures. For example, if a large number of exclusions or adjustments are authorized, it may be advantageous to specify a more restrictive allowable rate of increase.

18. The allowable rate of increase could be measured in several ways. The expenditure restraint program limits spending increases to a percentage equal to the sum of the inflation rate and an adjustment based on growth in municipal property values. The inflation rate is measured as the change that occurred in the consumer price index. The property value adjustment is unique for each municipality and equals 60% of the percentage change in the municipality's equalized value due to new construction, net of any property removed or demolished, but not less than 0% nor more than 2%. SB 40 proposes a similar measure for the county levy restraint program, but the combined percentage would be reduced to 85% of its initial value. Under the SB 40 levy limitation, each county's tax levy increase would be limited to the percentage change in the county's equalized value

due to new construction, net of any property removed or demolished, but not less than 4%. The same measurement was used under the 2005 Act 25 levy limitation that was sunset on January 1, 2007, but the minimum guaranteed rate of increase was set at 2%. Table 4 compares the statewide average increases under the Act 25 levy limitation measurement with the levy limitation and levy restraint measurements proposed in SB 40.

TABLE 4

Estimated Allowable Rates of Increase in Tax Levies Calculated on a Statewide Basis Under Three Controls, 2002-06

	Levy Limit Programs			Levy Restraint Program		
	Either Net New Construction	Or 2% (Act 25)	Or 4% (SB 40)	60% of Net New Construction	Consumer Price Index	Combined Factors at 85%
2002	2.54%	2.54%	4.00%	1.52%	1.77%	2.80%
2003	2.52	2.52	4.00	1.51	2.20	3.15
2004	2.61	2.61	4.00	1.57	2.19	3.20
2005	2.77	2.77	4.00	1.66	3.01	3.97
2006	2.90	2.90	4.00	1.74	3.81	4.72

19. If the county levy restraint program had been in effect in 2006(07), allowable rates of levy increase would have ranged from a low of 3.7% in four counties (Florence, Iron, Menominee, and Vilas) to a maximum of 4.9% in 19 counties. For the 72 counties, Table 5 reports the range in allowable rates of increase.

TABLE 5

Allowable Rates of Levy Increase Under the County Levy Restraint Program If the Proposal Had Been in Effect for 2006(07)

2006(07) Allowable Rates of Increase	Number of Counties	Percent
3.7%	4	5.6%
3.8% to 4.1%	8	11.1
4.2% to 4.5%	26	36.1
4.6% to 4.8%	15	20.8
4.9%	19	26.4
Total	72	100.0%

20. The comparisons in the previous point would have been significantly different if the consumer price index had been lower. Inflation for the period used for 2009 levy restraint payments is currently forecast at 1.8%. Replacing the 2006 CPI percentage in Table 4 with 1.8% would reduce the allowable rate of increase under the levy restraint program from 4.72% to 3.01%. Because the net new construction percentage for 2006 was also high relative to prior years and to the current level of construction activity, the allowable rate of increase in future years may decline to an even lower level.

ALTERNATIVES TO BILL

1. With three exceptions, approve the Governor's recommendation to do the following: (a) create county levy restraint and county levy restraint bonus programs to make payments beginning in 2009 to each county that has a tax levy that is no greater than its allowable levy as determined through a formula based on the inflation rate and the rate of tax base growth due to net new construction in the county; and (b) create two sum sufficient appropriations with annual funding levels beginning in 2009-10 of $15,000,000 GPR and $10,000,000 GPR, respectively, to make payments to eligible counties based on each county's tax levy as a percent of the sum of the tax levies for all eligible counties (basic program) and the amount by which each county's tax levy is below its allowable amount (bonus program). To achieve the proposal's original intent, modify the Governor's original recommendation to clarify that: (a) the calculation of the allowable levy pertains to the levy that is adopted in the year that is two years prior to the year of the aid payment; (b) the definition of taxable value excludes value increments, rather than tax increments, and also excludes value increments from environmental remediation and town tax increment districts; and (c) the calculation of payments under the basic program is based on an annual distribution of $15 million, rather than $25 million.

2. Approve the Governor's recommendations related to the county levy restraint program, as modified under Alternative #1, but delete the Governor's recommendation to create a county levy restraint bonus program.

3. Delete the Governor's recommendation to create a county levy restraint bonus program, but approve the Governor's recommendation to create a county levy restraint program (basic program), as modified under Alternative #1 and by replacing the program's eligibility requirement with the levy limit requirement proposed in SB 40, including any modifications adopted by the Committee, effective with payments in 2009, based on one of the following percentages of the allowable increase under the levy limit:

a. 100%; b. 90%; c. 80%;
d. 70%; e. 60%; or f. 50%.

4. Delete provision.

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