

Fiscal Policy Note

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Capping Property Taxes: What's Likely to Happen?

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On November 7, Alaskans will vote on whether to cap property taxes at 1 percent of assessed value—which would cost local governments 20 percent of property tax collections in the first year and 40 percent as time passed.

Supporters of the tax cap say property taxes are too high, property owners pay an unfair share of local government costs, and government is inefficient. Yet local spending in Anchorage and elsewhere hasn't changed much in recent years, if you take inflation and population growth into account. And Anchorage's local government employs fewer workers per resident than almost any U.S. metropolitan area.

So what's going on? Like most fiscal matters in Alaska, it relates to the rise and fall of oil wealth. As oil revenues dwindled in the 1990s, the state cut spending, including aid to local governments. Local taxes filled the gap.

So local taxes now pay more of local costs—but how does that fit into the big picture of revenues and spending?

- *Statewide, local government spending per person trended down in recent years, taking inflation into account. It is on a par with spending in earlier times.*

- *Property taxes in Anchorage now pay about 45 percent of combined general and school costs—up from 35 percent a decade ago, but similar to the 1970s share.*

- *Anchorage ranks 19th in property taxes per person among the largest cities in each state—but lowest in combined state and local taxes.*

- *State aid still pays a third of local costs, mostly for schools but some for general costs.*

Supporters of the tax cap say restricting property taxes would force local governments to be more efficient and to broaden their tax bases. But except for Anchorage and Fairbanks, most large Alaska communities already levy both property and sales taxes.

The biggest untapped local source is Anchorage's sales tax base—and Anchorage may want to consider a sales tax in the future, as state aid continues to dwindle. But remember that while property owners write the checks to pay property taxes, ultimately everybody pays—because businesses pass taxes on to customers, and landlords pass taxes on to renters. Also, sales taxes are not deductible on federal income taxes, and they fall harder on people with lower incomes.

The full fiscal and economic effects of the tax cap wouldn't be apparent for years. Local governments could tax at more than 10 mills (1 percent) until they paid existing debt on bonds. The cap would limit growth in assessments, with property assessed at market value only when it was sold; over time, the tax base would narrow.

Effects of Tax Cap



- *Alaska households would initially get \$109 million, averaging \$600 per household in Anchorage and different amounts elsewhere. Later gains would be \$280 million statewide.*



- *The economy would initially lose about 1,920 private jobs and 1,640 public jobs. After a number of years, private industry would replace roughly half those jobs.*



- *About 2,220 households would leave the state, depressing housing demand. But housing would be more affordable.*

- *Taxes on property of equal value would be higher for new buyers than long-time owners, as time went on.*



- *Initial cuts in local services and in the size of local governments statewide would be about 11 percent. Later, if local governments didn't add new revenue sources, the cuts would be about 22 percent.*

- *Local governments would no longer be able to finance public projects like road improvements, fire stations, and schools.*

Background

Close to 90 percent of Alaskans live in the 25 boroughs and cities that levy property taxes, with 1999 rates varying from 4.5 to 20 mills. Property taxes are used for day-to-day operating costs; for debt service on bonds; and for school district costs. About a third of the places that tax property levy more than 10 mills (or 1 percent) just for operating expenses.

Whenever possible, we looked at all local governments that tax property—but some of our figures are just for Anchorage. Our information is most complete for Anchorage, where about 40 percent of Alaskans live.

Trends in Anchorage Revenues and Spending

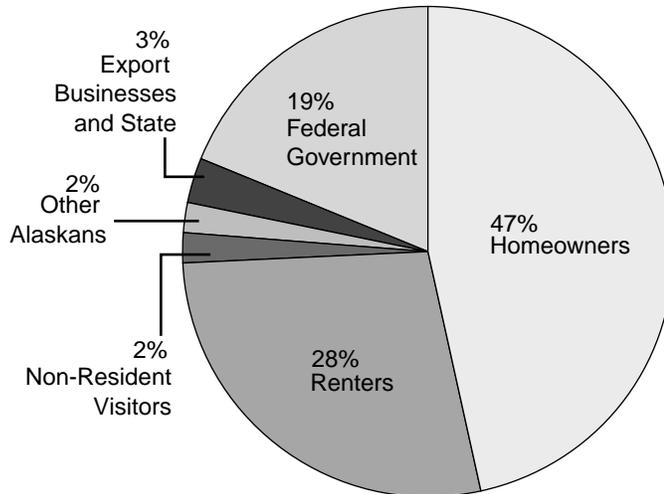
Figure 1 shows what happened in Anchorage in the 1990s. If we take into account inflation and population growth:

- Spending per person held steady.
- State aid per person dropped, but still pays more than half of school district costs.
- Residential property taxes per unit increased 46 percent while commercial property taxes per job increased 4 percent. By 1999, residential property made up 65 percent of Anchorage's property value and commercial property 24 percent. (Personal property makes up 11 percent of value.)

We also know Anchorage local government employment is low compared with other places:

- Anchorage has fewer local government employees per resident than almost any other metropolitan area. In 1998, Anchorage ranked 307 out of 318 metropolitan areas in the number of local government employees per 10,000 residents.

Figure 2. Anchorage Property Tax- Who Ultimately Pays?



Note: The shares would differ in other communities.

Who Pays the Property Tax?

Property owners write the checks to pay property taxes, but they don't bear all the costs. Figure 2 shows who actually bears the costs of property taxes in Anchorage, once businesses and landlords have passed them on to renters, customers, and the federal government. (The shares would differ in other communities.)

Homeowners pay 47 percent, renters 28 percent, and the federal government 19 percent (because of federal income tax deductions). Visitors from other Alaska places and outside Alaska pay 2 percent each—because businesses pass along taxes to customers. Export businesses pay 3 percent, because they sell on the world market and have to absorb the taxes. (Except for oil companies; for them, reduced local taxes mean increased state taxes, because the state and local governments share petroleum property taxes.)

So who would benefit from the tax cap?

- Anchorage households would eventually get 75 cents for every \$1 of property tax cuts—after competitive markets forced landlords and businesses to share the gains. They wouldn't get the full dollar, largely because they'd lose the federal income tax deduction on that money.
- Anchorage households would get about \$51 million in the first year, or about \$600 per household on average. That would increase over time, when the mill rate dropped to 10.
- In the North Slope Borough and Valdez, the tax cut would mostly go to the state government—because so much of the tax base in those places is petroleum property. The state currently shares its petroleum property taxes, but under the cap most would revert to the state.

Figure 1. Spending and Revenue Trends in Anchorage, 1993-1999

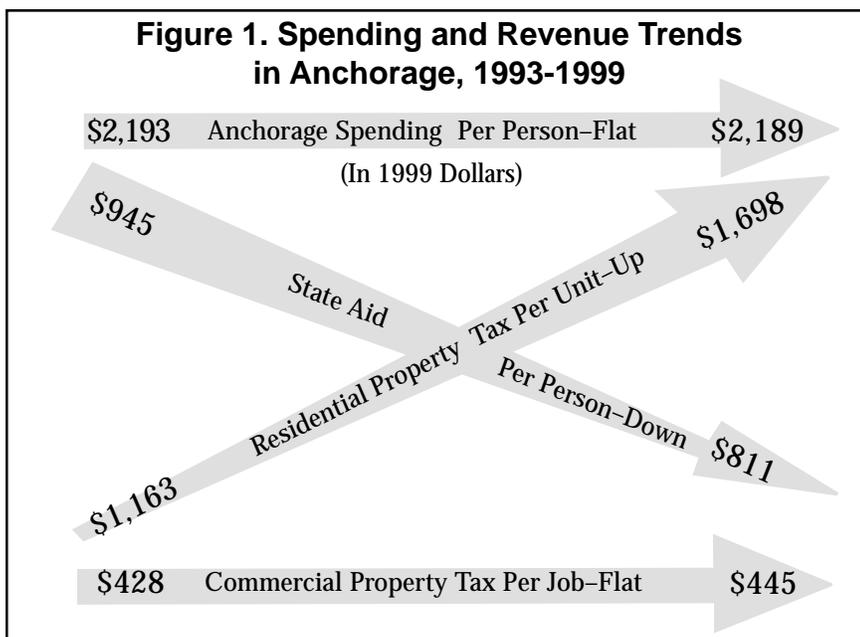
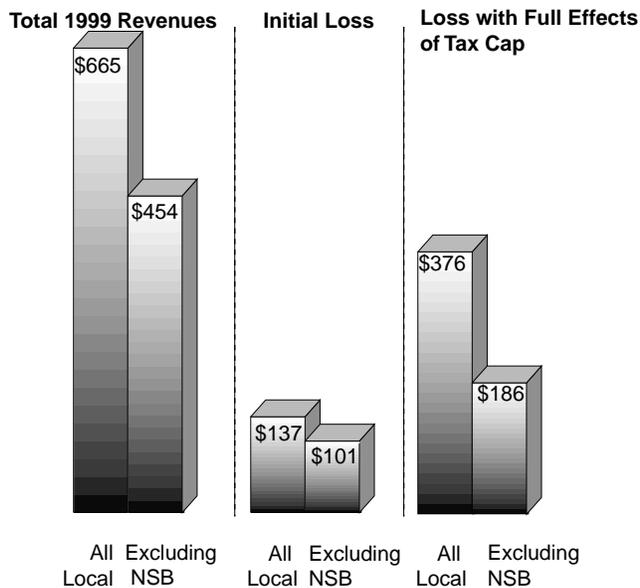


Figure 3. Statewide Property Tax Revenue Loss (In Millions of Dollars)



How Would Local Governments be Affected? —

Figure 3 shows the revenue implications for local governments, if the tax cap passes. Compounding the problem is that the value of petroleum property is declining and the value of property belonging to homeowners over 65—which state law exempts from taxes—is growing. The figure shows calculations including and excluding the North Slope Borough, which is unique. Its tax base is the billion-dollar North Slope petroleum property, and most of its tax collections pay for debt service on bonds.

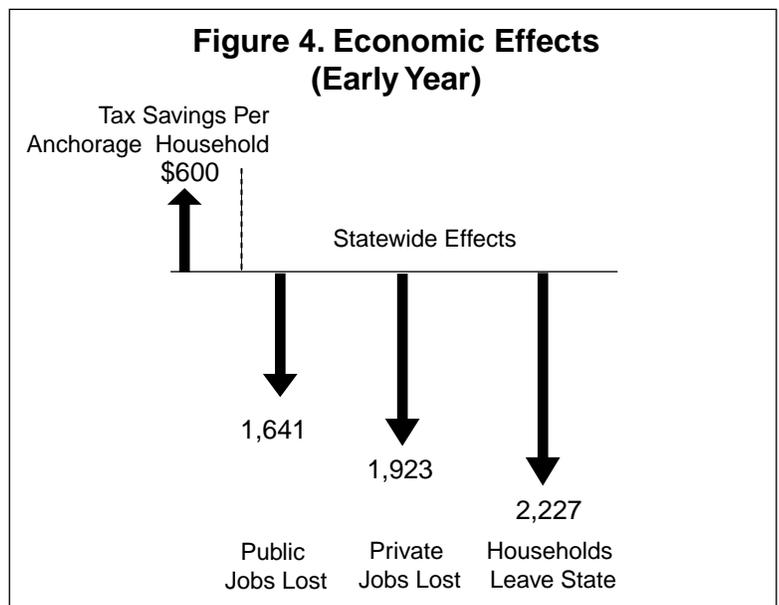
- Local governments around Alaska (excluding the North Slope Borough) would initially lose close to one-quarter of the property taxes they collect today.
- Longer term, local governments would lose 40 percent of what they otherwise would have collected. The dollar loss would double over time, because in many communities the tax rate would drop to 10 mills gradually, as existing debt on bonds was paid. Also, over time local governments would lose part of their tax base—because assessed value would lag market value.
- The North Slope Borough would be hardest hit over time, because so much of its property taxes pay for debt on bonds. Once that debt was paid, the borough would lose 90 percent of what it collects today.
- Local governments would lose their ability to finance public projects like road improvements, fire stations, and schools. Under a 10-mill limit, communities wouldn't be able to pay for both operating costs and debt service on bonds.
- Spending decisions would no longer be made at the local level, if local governments no longer had control of revenue-generating capacity.

How Would the Tax Cap Affect the Economy?—

The tax cap initiative doesn't include any mechanism for replacing lost property tax revenues. With no new revenues, local governments would make sharp spending cuts—which would hurt the economy.

- Households would gain a total of about \$109 million at first and \$280 million later. The average savings per household would vary among communities.
- About 3,560 Alaskans statewide would lose their jobs initially (Figure 4). Those job losses would cost the state about \$14.5 million in income. Eventually—after years—about half those jobs would be replaced because of increased household buying power.
- About 45 percent of those who lost jobs would be government workers.
- Nearly 55 percent who lost jobs would be in private industry. Construction workers would be hard hit because work on local public projects would disappear, once the projects already in the pipeline were finished. Others would include those who provide contract services to local government (like school bus drivers). Others would lose their jobs in trade and service industries, as the effects of other jobs losses worked through the economy.
- About 2,220 households would leave Alaska to find jobs elsewhere, reducing housing demand.
- Lower property taxes would reduce the cost of housing for both owners and renters—although it would take longer for market forces to reduce rents.
- Property sales would slow, because new buyers would pay higher taxes than long-time owners for comparable property. This inequity (created because property would be assessed at market value only when it sold) could discourage newcomers as well as long-time residents who wanted to move within the community.

Figure 4. Economic Effects (Early Year)



How Else Might We Pay for Local Government? —

Some Alaskans believe state government would step in and pay more local government costs if the tax cap passes, even though state aid to local governments has been steadily dropping, and the state faces its own fiscal gap as oil revenues decline. Still, if we assume that the state might pick up more local costs, what possibilities are mentioned most often?

The state government taxes petroleum property, but it currently shares most of that revenue (82 percent) with local jurisdictions that have petroleum property—mainly the North Slope Borough and Valdez. If the tax cap passes, most of that shared revenue would revert to the state government, because it would put local governments over the 10-mill limit.

Proponents argue that the state could re-distribute petroleum property taxes among all local governments, to help make up losses from the tax cap. Those taxes represent about \$42 million of the initial shortfall and \$187 million later on. Even if the state distributed that money to local governments, they would still have an annual deficit of \$85 million at first and \$166 million ultimately. What else might the state do to fill the remaining deficit?

- *Combine state corporations and use their assets to generate earnings to help pay for local government.* The assets of these corporations are not large enough to generate \$166 million a year. Also, the corporations use those assets as collateral to sell bonds for financing projects and they pay dividends that help pay state government costs. And it would be difficult and costly to combine corporations with different purposes.
- *Use “excess” Permanent Fund earnings.* As every Alaskan knows, the state uses a portion of Permanent Fund earnings to make annual cash payments to residents and a portion to protect the principal of the fund against inflation. So far the legislature has re-deposited any leftover earnings back into the fund. While such leftover earnings could help pay for local governments, continuing to re-deposit them boosts the size of the Permanent Fund (and potentially the size of dividends). And the state itself, which faces its own deficit, needs to consider how to use those earnings in a long-run fiscal plan, as oil revenues drop.

Yet another idea sometimes raised is that the state levy a flat tax on every Alaska worker. Some people favor this plan because it would tax non-resident workers, who make up about 20 percent of the work force. Similarly, some Alaskans propose filling the deficit by having the state somehow tax tourists who visit Alaska.

- *Every worker in Alaska would have to pay \$400 annually to raise enough to fill a statewide local government deficit of \$166 million.* This would be an especially inequitable tax, because it would fall equally on anyone who had a job—whether that worker’s wages were \$15,000 or \$150,000.
- *Every tourist who came to Alaska would have to pay \$166 for the privilege, in order to raise \$166 million annually.*

Other revenue possibilities include local sales taxes, but most larger communities—except Anchorage and Fairbanks—already levy a sales tax. We can’t assess potential sales tax revenues in all Alaska places, but we can make an estimate for Anchorage, which would face the largest immediate loss under the cap—\$64 million, growing to \$125 million. Anchorage could (if voters approved) add a sales tax.

- *A year-round sales tax of 3.5 percent on all retail sales in Anchorage could raise about \$125 million per year.* But Anchorage residents would bear a larger share of a sales tax than of a property tax—mostly because sales taxes aren’t deductible on federal income taxes. Also, sales taxes fall harder on lower-income residents.
- *If Anchorage attempted to pass more tax on to visitors through a seasonal tax, the rate would have to be 10 percent to raise \$125 million annually.* That’s certainly high enough to discourage not only visitors but locals from buying.

Conclusions and Implications —

Alaskans supporting the tax cap have a point: some property taxes—in particular, residential property taxes in Anchorage—did rise sharply in the 1990s. But it’s not true that local government spending has skyrocketed. What has happened is that as the state’s Prudhoe Bay wealth declines, Alaskans are paying more of the costs of local government—including costs of schools, which are by far the largest single local government expense.

And the increase has fallen on property owners—although even at their current level, property taxes in Alaska are not out of line with either historical Alaska levels or levels elsewhere. Alaskans still pay less state and local tax than other Americans, because we pay no state personal taxes. In fact, the state pays us Permanent Fund dividends.

Still, it may be time for Anchorage and other local governments that rely heavily on property taxes to look at other local sources. Anchorage also needs to investigate why residential assessments have risen so much faster than commercial assessments.

The tax cap would be one way to cut the burden of the property tax—but at the cost of economic disruption and deep cuts in public services. Alaskans and their local governments should consider the full range of alternatives for achieving tax equity and government efficiency. The question is how to reach those goals, with minimum disruption of the economy and of the public services and facilities that make Alaska’s communities good places to live and do business.

This paper is based on a series of more detailed analyses by the authors, posted on ISER’s Web site at www.iser.uaa.alaska.edu under “Economic and Fiscal Analyses.” You can also get copies of the papers by calling ISER (907-786-7710) or stopping by our offices in the Consortium Library Building at UAA.