THE STATEWIDE TAX CAP SQUEEZE

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October 6, 2000

A property tax cap of 10 mills would restrict the ability of local governments to utilize one of the two tax bases traditionally available to them—the property and sales taxes-- at the same time that their revenue generating capacity is being eroded by growing senior exemptions, disappearing state revenue assistance, and a declining petroleum property tax base. Together the falling ceiling and the erosion of revenue sources would constrain the ability of local governments throughout the state to pay for necessary public services.

THE FALLING CEILING

Most Alaskan households (89 percent of the population—556 thousand) live in the 25 communities that impose a property tax. Property tax rates in 1999 varied from a low of 4.5 mills in Haines to a high of 20 mills in Valdez.

The tax cap would restrict spending for operations and servicing debt incurred for new capital construction, but debt service for previously incurred debt would be exempt, or "grandfathered" into the mill rate. So in its first year the mill rate would allow up to 10 mills of operations spending plus any "grandfathered" debt service. Revenues would be cut $137 million in ten communities. (This estimate is based on collections and rates in effect in 1999. The cap would go into effect in 2001 so the revenue loss would be somewhat higher due to growth in the tax base and inflation.)

The ultimate revenue loss from the tax cap would be two to three times this amount (assuming no tax base growth or other changes in mill rates in future years). State wide the out year loss would be $376 million, nearly 3 times the $137 million first year loss. Excluding the North Slope Borough, the out year loss would be $186 million, nearly twice the $101 million first year loss. Two factors account for this—the retirement of "grandfathered" debt service and assessment lag.

First Year Revenue Loss

The statewide local government revenue loss, if the tax cap had been imposed in 1999, would have been $137 million. Only ten communities, with a population of 453 thousand would be affected—those communities where more than 10 mills of property taxes pay the operating expenses of government. Most of the loss would be concentrated in the communities of Anchorage, the North Slope Borough[1], Fairbanks, Valdez, and the Matanuska-Susitna Borough (Table 1. and diagram).

Mill rates in these communities would not immediately fall to the 10 mill cap. The cap "grandfathers" debt service payments so actual mill rates in the first year of a cap would be the sum of the mill rate for operations, up to the 10 mill cap, plus the mill rate for "grandfathered" debt service.

Retirement of Grandfathered Debt Service

Over time the retirement of "grandfathered" debt service would further reduce local government revenues in these and other communities as mill rates gradually all fell to the 10 mill limit.

When all this "grandfathered" debt service has been retired, communities would be able to spend their property taxes on either operations or servicing new debt as long as the total stayed under the tax cap.

The retirement of "grandfathered" debt would take many years, but eventually the maximum mill rate in every community would fall to 10 mills. If the tax cap had been imposed in the 1980s the cap throughout the state would be 10 mills by today. Table 1. shows the revenue loss in 1999 at a 10 mill cap for all communities.

Taking debt retirement into account adds $213 million to the lost revenues, $60 million excluding the North Slope Borough. The total loss would have been 53 percent of property tax revenues statewide, or $349 million. Net of the North Slope Borough the loss would have been 36 percent, or $161 million. The North Slope Borough and Anchorage would account for most of the revenue loss associated with "grandfathered" debt.

Assessment Lag

Over time another provision of the tax cap would further erode the property tax revenues of these and other communities with mill rates close to the 10 mill cap. The tax cap would limit the annual increase in assessed value of property to 2 percent except when the property was sold. At the time of sale the property would be assessed at the sale price (not necessarily the market price).

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[1] The North Slope Borough is a special case. Their assessed value for the purpose of determining property tax revenues for operations is only a fraction of the total assessed value of property in the Borough. Consequently although the level of their operations spending implied an operations mill rate of 5.02 in 2000, the effective operations mill rate was 24.39 mills. See Alaska Taxable 1999, page 25.

Table 1.
10 MILL PROPERTY TAX CAP
FIRST AND OUT YEAR REVENUE EFFECTS BY COMMUNITY
(MILLION $)

Community Imposing Property Tax	Actual Property Taxes Collected in 1998	Revenue Loss: First Year Cut in Operations 1	Revenue Loss: Out Years Cut in Capital 2	Revenue Loss: Out Years from Below Value Assessments 3	Revenue Loss: Out Years Total 1+2+3	Percent Loss of Property Tax: First Year	Percent Loss of Property Tax: Out Year	Mill Rate: Today	Mill Rate: First Year With Cap	Mill Rate: Out Year With Cap	Excess Property Tax Capacity With Cap
STATE TOTAL	$664.5	$136.7	$212.6	$26.7	$376.0	20.6%	56.6%				$5.7
TOTAL NET NORTH SLOPE BOROUGH	$453.5	$101.2	$60.1	$24.4	$185.7	22.3%	41.0%				$5.7
COMMUNITIES WITH OPERATIONS SPENDING OVER CAP	$609.6	$136.7	$212.0	$26.0	$374.7	22.4%	61.5%				
Anchorage	$252.0	$64.3	$49.0	$13.9	$127.1	25.5%	50.4%	18.2	13.5	10.0	-
North Slope Borough	$211.0	$35.5	$152.5	$2.3	$190.3	16.8%	90.2%	-	-	-	-
Fairbanks	$59.9	$18.5	$4.4	$3.7	$26.6	30.9%	44.4%	16.2	11.2	10.0	-
Valdez	$17.6	$8.8	$0.0	$0.9	$9.7	50.0%	55.0%	20.0	10.0	10.0	-
Matanuska Susitna Borough	$36.8	$7.7	$2.8	$2.6	$13.1	21.0%	35.7%	14.0	11.1	10.0	-
Juneau	$25.8	$1.1	$3.2	$2.1	$6.5	4.2%	25.1%	12.0	11.5	10.0	-
Nome	$1.9	$0.3	$0.0	$0.2	$0.5	16.7%	25.0%	12.0	10.0	10.0	-
Cordova	$1.5	$0.3	$0.1	$0.1	$0.5	20.8%	35.7%	14.0	11.1	10.0	-
Wrangell	$1.2	$0.2	-	-	$0.2	16.7%	16.7%	12.0	10.0	11.1	$0.0
Bristol Bay Borough	$2.0	$0.0	$0.0	$0.2	$0.2	2.4%	12.2%	10.3	10.0	10.0	-
COMMUNITIES WITH DEBT SERVICE SPENDING OVER CAP	$4.0	$0.0	$0.6	$0.3	$1.0	0.0%	23.5%				$0.0
Unalaska	$3.9	-	$0.6	$0.3	$0.9	0.0%	23.6%	11.8	11.8	10.0	-
Nenana	$0.2	-	$0.0	$0.0	$0.0	0.0%	21.7%	11.5	11.5	10.0	-
COMMUNITIES LESS THAN 10% UNDER CAP	$8.4	$0.0	$0.0	$0.4	$0.4	0.0%	4.2%				$0.0 -
Kodiak	$6.6	-	-	$0.2	$0.2	0.0%	2.7%	9.3	9.3	10.0	-
Petersburg	$1.8	-	-	$0.2	$0.2	0.0%	10.0%	10.0	10.0	10.0	-
COMMUNITIES MORE THAN 10% UNDER CAP	$42.4	$0.0	$0.0	$0.0	$0.0						$5.7
Haines	$0.8	-	-	-	$0.0	0.0%	0.0%	4.5	4.5	5.0	$0.8
Kenai Peninsula Borough	$28.2	-	-	-	$0.0	0.0%	0.0%	8.6	8.6	9.6	$1.3
Ketchikan	$7.1	-	-	-	$0.0	0.0%	0.0%	7.5	7.5	8.3	$1.4
Sitka	$3.3	-	-	-	$0.0	0.0%	0.0%	6.0	6.0	6.7	$1.6
Yakutat	$0.3	-	-	-	$0.0	0.0%	0.0%	9.0	9.0	10.0	$0.0
Craig	$0.4	-	-	-	$0.0	0.0%	0.0%	6.0	6.0	6.7	$0.2
Dillingham	$1.0	-	-	-	$0.0	0.0%	0.0%	8.0	8.0	8.9	$0.1
Eagle	$0.0	-	-	-	$0.0	ERR	ERR	0.0	0.0	0.0	$0.1
Pelican	$0.1	-	-	-	$0.0	0.0%	0.0%	6.0	6.0	6.7	$0.0
Skagway	$1.2	-	-	-	$0.0	0.0%	0.0%	8.8	8.8	9.8	$0.0
Whittier	$0.2	-	-	-	$0.0	0.0%	0.0%	5.0	5.0	5.6	$0.12

SOURCE: Based on data from Alaska Taxable for 1999, an unpublished analysis by the state assessor, and authors' estimates.

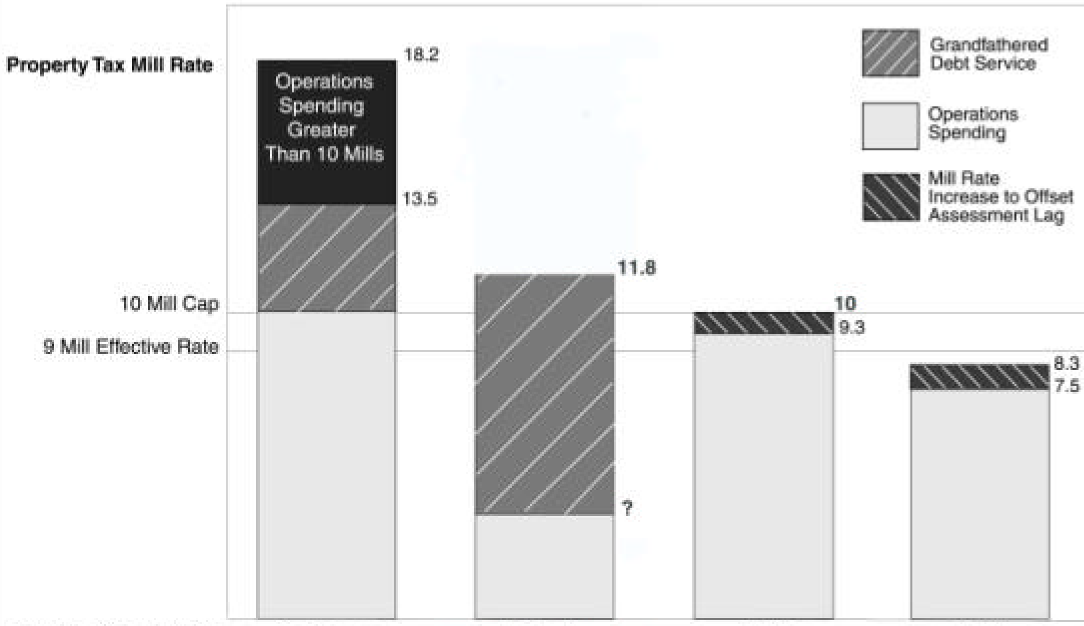
NOTES TO TABLE:

It is unclear how the tax cap would be interpreted for the 11 Boroughs that contain incorporated cities.
(For example, the Kenai Borough imposes a property tax on top of the city of Kenai property tax.)
In this analysis we assume that the sum of the property taxes imposed by local gtovernment could not exceed 10 mills in any location.
Unified Home Rule Boroughs are Anchorage, Juneau, and Sitka. Yakutat and Bristol Bay Borough contain no incorporated cities.

Revenue loss is based on the assumption that communities above the cap will cut their mill rates to the cap but no lower.
Communities with debt service spending over the cap can undertake new capital construction, as long as the debt service does not exceed the cap.

In communities below the cap, mill rates will need to rise to maintain property tax revenues when assessment lag commences.
Assessment lag occurs when growth in assessed values falls behind growth in the market value of property.

How the Tap Cap Affects Different Communities



Example Community:	Anchorage	Unalaska	Kodiak	Ketchikan
Property Tax Characteristics:	Operations > 10 Mills With Debt Service	Operations < 10 Mills With Debt Service	Operations < 10 Mills No Debt Service	Operations < 10 Mills No Debt Service
When Affected:	**Affected First Year**	**Affected in Out Years By Retirement of Grandfathered Debt**	**Affected in Out Years By Assessment Lag**	**Affected in Out Years By Assessment Lag**

Since property values are likely to continue to increase at a rate at least equal to inflation, which historically has averaged about 3 percent, the assessed value of property will tend to lag behind its market value, unless all property changed hands through sale every year.

This gradual erosion of the property tax base—assessment lag--has been particularly severe in some cities in California where property has appreciated rapidly and turned over slowly. The effective mill rate (property taxes collected / market value of property) in some California communities is less than 6 mills, little more than half the 10 mill statutory rate imposed by their tax cap.

Although it is unlikely that such a low effective mill rate would happen here, the effective mill rate will gradually fall below the statutory rate, and could easily be 9 mills in a few years. (This based on 4 percent inflation and an 8 year holding period for property).

Assessment lag at this rate eventually adds $27 million to the local government revenue loss from the tax cap. This increases the total out year revenue loss to $376 million and extends it to 14 communities with a population of 475 thousand (76 percent of the state total). The total loss is equal to 57 percent of property taxes collected in 1999 and 41 percent of property taxes collected net of the North Slope Borough.

Unaffected Communities

At current property tax mill rates, 11 communities would be unconstrained by the 10 mill cap. One of these has a mill rate of 9 that would just put it "on the line" with no excess capacity (taking into account assessment lag). The rest have mill rates less than 9 mills. Their combined "excess capacity", the amount of additional revenues they could generate if they taxed up to the effective cap, is $5.75 million, over and above their actual collections of $42.4 million.

Although these communities would not lose property tax revenues, assessment lag would require that they increase their mill rates to prevent a loss of revenues. If they did not raise their mill rates their revenues would fall below what they would have been in the absence of the tax cap.

New Capital Construction

With the tax cap, payment of the debt service for any new capital construction financed by general obligation bonds would need to fit under the 10 mill limit. The ten communities at the 10 mill limit for operations would be unable to take on new debt without further reducing operating expenditures. Only communities spending less than 10 mills for operations would be able to continue some debt financed capital construction without further reducing their operating expenditures.

Shift of Petroleum Tax Revenues to the State

If the tax cap had been in place in 1999 state petroleum property tax revenues would have increased by $44.5 million at the expense of local governments—primarily the North Slope Borough, Valdez, and Fairbanks. This is because the state collects a 20 mill property tax on petroleum property and passes a share on to those local governments that have taxable petroleum property. The amount shared with these local governments is based on the local property tax mill rate. Reducing the local mill rate increases the share of petroleum property taxes retained by state government.

Over time the amount retained by the state would increase as local tax rates fell to 10 mills. If the full effect of the tax cap were in effect in 1999 the state would have retained $187.8 million more than it did. Net of the North Slope Borough the loss would have been $10.7 million. These local government revenue losses are included in Table 1. (Since petroleum property assessments are falling, the actual loss in the future would be less than this amount.)

EROSION OF REVENUE SOURCES

Three revenue sources that local government has relied upon in the past to support public spending have been dropping. Table 2. shows that together they have fallen by 50 percent since 1990. By 2010 they may be providing less than half as much revenue as today, or only a third as much per person. Property taxes have been shouldering a larger share of the total revenue burden, and demand on the property tax will continue to grow in the future.

Table 2. Decline of Some Important Local Government Revenues (million 1999$)

	1990	**2000**	**projected 2010**
Total	$412	$210	$74
Petroleum Property Tax	$308	$209	$142
State Assistance	$116	$ 31	$ 11
Senior Citizen Exemption	-$ 11	-$ 29	-$ 79
Population (000)	553	625	700
Total per Capita ($)	$745	$336	$105

Growing Senior Exemption

Statewide in 1999 tax exemptions totaling $27 million were granted to senior citizens—6.3 percent of actual collections. (Without this exemption mill rates could have been about 5.6% lower.) The dollar value of these exemptions has been growing much faster than actual property tax collections (13 percent per year vs. 6 percent per year since

1990). At this rate the exemption would grow to $79 million in 2010 (1999$), 12 percent of actual collections. (Without this exemption mill rates could be 11 percent lower in 2010.)

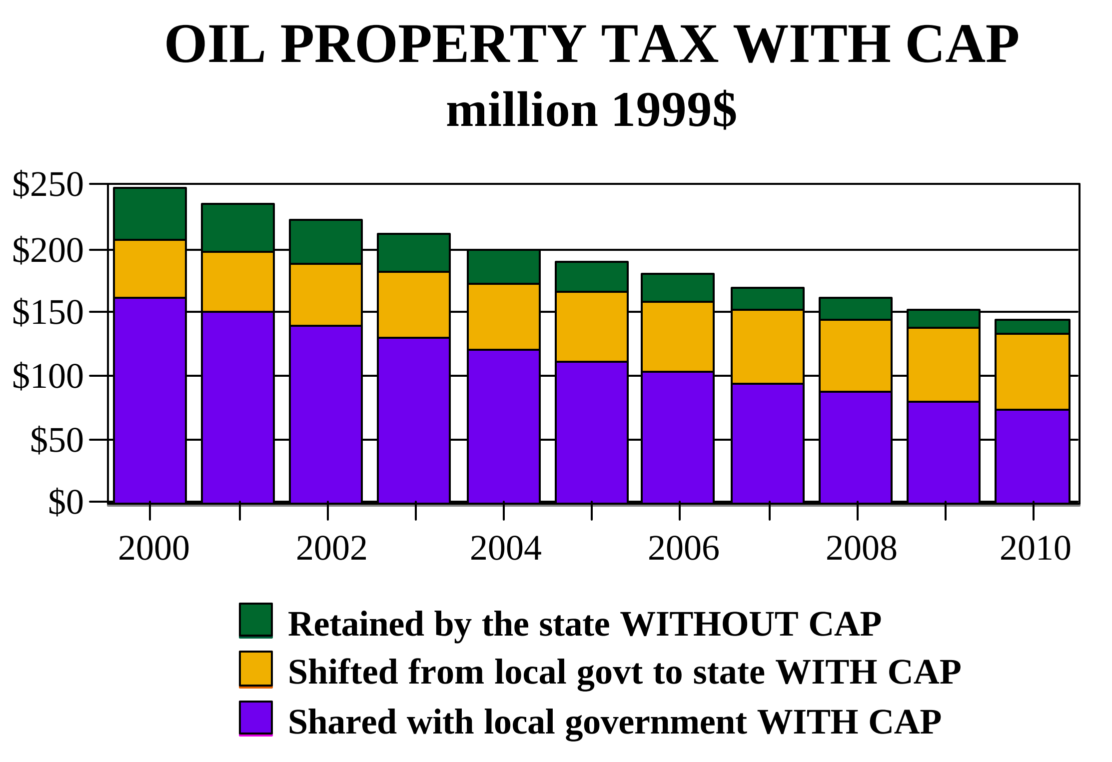
Falling State Fiscal Assistance

Local revenues from state revenue sharing and municipal assistance peaked in 1982 at $144 million, $222 million in 1999$. In fiscal year 2001 the appropriation was $28.5 million. Continuation of the trend since 1990 would reduce this assistance to $11 million by 2010 (1999$). Education support (not included in Table 2.), both the foundation program for operations and debt repayment for construction of new facilities, has also been falling in real dollars.

Erosion of the Petroleum Tax Base

Local revenues from the taxation of petroleum property peaked in 1986 at $274 million, $383 million in 1999$. By 1999 revenues had fallen to $217 million. Continuation of this trend would reduce local petroleum taxes to $142 million by 2010 (1999$) in the absence of the tax cap.

However with the cap, local governments would get a smaller share of this shrinking tax base due to the shift in revenues to the state government. With the tax cap local governments would get only about 75 million by 2010 (Figure 1.).



Assumes .5 mill annual reduction in actual mill rate in effected local communities