

Committee's Property Tax Reform Package

Whatever it is . . . It isn't Question 1A

The special legislative committee charged with reviewing Governor Baldacci's tax reform proposal convened over last weekend and late into Monday night this week before voting 12-3 that the proposal, as amended by the Committee, "ought to pass". The bill is LD 1.

LD 1 was supposed to be the Governor's approach to implementing the School Finance and Tax Reform Act of 2003 (a.k.a., Question 1A), the citizen initiative supported by MMA that voters adopted on June 8, 2004.

Whatever LD 1 is, it isn't Question 1A!

The centerpiece of both the Governor's proposal and now the Committee's amended bill is a four-year, phased-in implementation of the state's obligation to provide 55% of the cost of K-12 education, measured by a new school funding model called "essential programs and services" (EPS). The phase-in to 55% school funding in LD 1 closely resembles the phase-in to 55% funding that would have been provided if the voters had adopted the Legislature's 2003 competing measure, known as Question 1B. Instead of Question 1B's five-year ramp to 55%, LD 1 would install a four-year ramp.

Another key component of LD 1 is a \$15 million annual expansion of the "circuit breaker" property tax and rent rebate program, creating expanded eligibility and benefit guidelines that also closely resemble the circuit breaker

changes that would have been implemented if the voters had adopted the Legislature's Question 1B competing measure.

Other elements of LD 1 include a consciousness-raising spending limitation system, an expanded Homestead Exemption but with no additional state dollars, and a Municipal Revenue Sharing Program redistribution.

LD 1 carves its own path to property tax reform and sets aside key components of the citizen initiative—Question 1A—that was twice supported by the Maine voters, and actually enacted into law on June 8, 2004. Coincidentally, the citizen initiative becomes operational law today, January 14, 2005.

A disregard for a law enacted by Maine voters concerns us deeply, but it's not our only concern about LD 1. The fundamental goal of Question 1A was to increase state support for school funding so that the property tax bills all across Maine would be reduced when they are sent out next fall. Unfortunately, LD 1 does not make that possible across large geographic sections of Maine. We also have serious questions about the property tax shifting that is contained in the LD 1 and LD 2 package under the name of "property tax reform". It's ironic that the Committee members were so adamant about not shifting the property tax burden onto State tax resources, yet they seemed very willing to shift the property taxes from one group of property

taxpayers to another.

This issue of the Legislative Bulletin is divided into three parts.

First, starting on page 2 is an article about an electronic survey of MMA's Legislative Policy Committee (LPC) that was sent out earlier this week. Legislative leadership is demanding that LD 1 be enacted immediately, so MMA staff did not have time to call a meeting of the LPC. Instead, we are getting the views of LPC membership via the electronic survey. Municipal officials should feel free to let MMA staff know how you would answer the nine questions asked in the survey that are designed to define the Association's position on LD 1, as endorsed by the legislative committee.

Second, on page 4 an article describes the effort MMA is making to define the actual property tax relief that could reasonably be achieved on both a regional and local basis with the adoption of LD 1. This project uses exclusively the data that was provided to the legislative committee, and should be completed early next week. The intention is to transfer the data to a map of the entire state, so the local and regional impacts can be visually assessed.

Third, the article on page 5 examines some of the claims that have been made in the press about the impacts of LD 1, and attempts to correct some of the greatest inaccuracies in the "spin" that the newspapers pick up and convey to the public.

MMA Policy Committee Surveyed on LD 1 & LD 2

On Wednesday, January 12, an electronic survey of MMA's Legislative Policy Committee was conducted so that the MMA staff could get rapid feedback on the LPC's position as it relates to the components of LD 1 and LD 2. As press time for this *Bulletin*, about half the LPC had responded to the survey. What follows is a listing of questions contained in the survey with a summary giving background on each question.

Municipal officials who are not members of the Legislative Policy Committee are encouraged to provide feedback to the MMA State & Federal Relations staff as well.

Because of the hectic pace of the Legislative Session during the next week, the staff would prefer email correspondence. Email your thoughts to Geoff Herman at gherman@memun.org. If you do not have email capabilities, you could fax a letter to Geoff at 626-5947 or call Laura Veilleux at 1-800-452-8786 (ext. 207).

Introduction

The foundation of the property tax package is LD 1, which has five separate but interrelated elements:

- Education funding, through a four-year phase-in to 55% state funding by FY 2009. (To view this spreadsheet, see MMA's Tax Reform web site.)
- A consciousness-raising spending limitation system on state,

county, schools and municipalities.

- A \$15 million annual expansion in the circuit breaker property tax and rent rebate program.
- Raising the face value of the homestead property tax exemption to a flat \$13,000, with the state reimbursing just 50% of the lost tax revenue.
- A restructuring of the municipal revenue sharing program that moves \$14 million within the program from the traditional revenue sharing distribution formula to the so-called "Revenue Sharing II" formula, with a net result of moving \$7 million away from lower mill rate communities to higher mill rate communities. (To view this spreadsheet, see MMA's Tax Reform website.)

LD 2 is a proposed constitutional amendment that would authorize (but not require) municipalities to adopt local tree-growth-type programs whereby a Maine resident homeowner could enroll the land under his or her primary residence. Once enrolled, the assessed value of that land could not be increased more than a CPI adjustment on a year-to-year basis. Upon a change in ownership, a farmland-type or tree-growth-type penalty would be assessed.

The following summary briefly describes each element of the proposal, and outlines the supporting and oppositional arguments. The LPC was asked to give their position on a sliding scale ranging from "strongly support" to "strongly oppose" on each of these questions. A final question asked for their position on the entire package.

QUESTION 1: Do you support the Committee's majority recommendation to phase in education funding over a four-year period?

Summary: The proponents argue that by phasing-in the 55% school funding requirement over a four-year period, the state is able to meet its obligation without raising

state taxes and without cutting into state expenditures that support other state-funded programs.

The opponents (minority report) support a more aggressive approach that would compel the state to meet the 55% obligation within two years, rather than four years. They argue that the voters adoption of Question 1A on June 8th should be more faithfully adhered to, that that the June 8th vote was directing the Legislature to re-prioritize its spending decisions, and that a more aggressive funding schedule would provide much more substantial property tax relief.

Governor Baldacci has gone on record opposing any form of state tax increase, which has effectively taken that option off the table. Although some legislators take the general municipal position that a mix of state spending cuts and new state tax revenues (perhaps by expanding the sales tax base) should be applied in order to more aggressively meet the state's education funding requirement, the legislative committee has firmly and nearly unanimously rejected that approach.

The survey also asked a subsidiary question:

QUESTION 1-A: Do you support the Committee's minority recommendation to phase in education funding over a two-year period, recognizing that the intention is to obtain the necessary revenue by cutting other state programs?

QUESTION 2: Do you support the Committee's recommendation regarding the system of spending limitations to be imposed on state, county, school and municipal government?

Summary: The spending limitation system that would be applied to all levels of government in a relatively uniform way is best characterized as a "consciousness-raising" system. It is characterized that way

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because although certain formulas are used to identify a spending growth allowance for the state, counties, schools and municipalities, the governance mechanisms that must be employed to override those defined limits are generally same as the governance mechanisms that are currently used to adopt a state, county, school or municipal budget. That is, no especially difficult or restrictive “override” procedures are required, such as a 2/3 supermajority requirement or required referendum voting.

QUESTION 3: *Do you support the Committee’s recommendation to expand the circuit breaker program by increasing eligibility and benefits. The proposal would increase state costs from a \$29 million annual rebate program to a \$44 million annual rebate program?*

Summary: The Committee appeared unanimous in its support for expanding the circuit breaker program because it “targets” property tax relief to Maine residents and to those households that endure the highest property tax burden in relation to household income. Issues for consideration are the relative benefits of broad-based or targeted property tax relief, the fact that the current circuit breaker program is not being utilized by many eligible households, and the apportionment of an additional \$15 million in state revenue annually into the circuit breaker program rather than education funding.

QUESTION 4: *Do you support the Committee’s recommendation to create a flat \$13,000 homestead exemption, with just 50% of the exemption being reimbursed by the state?*

Summary: Municipal officials are well aware of the changes the Legislature made last session to the homestead exemption program, creating a “graduated benefit” system that reduced the value of the exemption from \$7,000 to \$5,000 for homesteads over \$125,000 in value and to \$2,500 for homesteads valued at over

\$250,000. The Committee is recommending increasing the face value of the homestead exemption to a flat \$13,000, but only reimbursing municipalities for 50% of their lost revenue. The portion of the homestead exemption not reimbursed by the state represents a system that creates an effective split-rate tax system where the homesteaders’ effective tax rate is less than the effective tax rate paid by businesses, vacation property, renters, and land-only property within the community. To put it another way, the Committee’s recommendation creates a “real value” homestead exemption for all homesteaders of \$6,500, and a “variable value” exemption for those homesteaders which depends on the taxable property make-up of the community. For example, for a hypothetical community that is made of entirely of homesteaders, there would be no “variable value” for those homesteaders because the town’s mill rate would go up, and the mill rate increase would be equally off-set by the unreimbursed exemption. In that case, 50% of the homestead exemption would be entirely phantom. In another hypothetical community that had a tax base made up of one homesteader and a tremendous amount of non-homestead property, the single homesteader would actually receive the value of the full \$13,000 homestead exemption because the costs of the unreimbursed homestead exemption would be picked up by the non-homestead taxpayers.

QUESTION 5: *Do you support the Committee’s recommendation to change the revenue sharing distribution system?*

Summary: As municipal officials are aware, the current municipal revenue sharing program is divided into two parts. Of the \$120 million that is projected to be distributed next year to the municipalities, \$114 million would be distributed through the traditional “Revenue Sharing I” formula, and over \$6 million would be distributed through the “Rev II” formula, which deducts 10 mills from every municipality’s

full value mill rate in the distribution calculation, thus distributing more of those “Rev II” funds to the higher mill rate communities. The Committee proposal would change the “Rev I” and “Rev II” cut-off points so that \$100 million would be distributed under the traditional “Rev I” formula and over \$20 million would be distributed through the “Rev II” formula.

The survey called for the LPC’s bottom-line position on the proposal through two questions:

QUESTION 6: *(Final Question on LD 1) Taking all these elements of LD 1 into account, do you support the Committee’s “ought to pass” recommendation on LD 1?*

QUESTION 6-A: *Taking all these elements of LD 1 into account, do you support the minority report of the Committee, which is LD 1, as amended, except with a two-year funding ramp for education?*

QUESTION 7: *Do you support LD 2?*

Summary: LD 2 is a separate bill that if supported by 2/3 of both the House and Senate would send out the voters in November the proposed constitutional amendment described above. It is described by the Committee as a special “tool” in the property tax reform “toolbox” that municipality’s could choose to adopt if they wished to address the issue of spiking residential valuations, particularly on waterfront properties. Some Committee members suggest that LD 2, along with many of the other constitutional amendments the Committee will be proposing, is an acknowledgement that all the property tax issues cannot be addressed by increased school funding alone, and these “tools” provide an opportunity for municipalities to address the property tax problems associated with high valuation internally. Other observers believe these “tools” are a way of the Legislature avoiding the issues directly, pushing the political controversies to the local level, and will be very complicated, difficult to administer, and difficult to explain.

Calculating the Impact of LD 1

LD 1 contains two proposals which have broad-based impacts on how much money towns will have available (or not) to lower property taxes on a town-wide basis in FY 06. The first proposal increases education aid by approximately \$90 million next year and then distributes all education aid through the new EPS-based funding formula. The second proposal, while providing no additional revenue, adjusts how existing revenue sharing aid will be distributed.

We have attempted to review the impact of both of these changes on each Maine municipality in an attempt to determine the net municipal impact of LD 1. That analysis will be distributed early next week. Excluded from the analysis are the targeted measures in LD 1 of expanding the circuit breaker and possibly increasing the homestead. In each case, the town is not being given extra funds by which it could lower its mill rate or its levy. In fact, the homestead proposal raises mill rates in every community; some taxpayers are adversely affected by this (e.g. renters and businesses) and others (owner-occupiers) are helped by the increased exemption. Nevertheless, these proposals are targeted to individual taxpayers and do not impact municipal taxes evenly across the town.

Our analysis focuses on the likely changes to the property tax bills that will be sent out next September.

Education

The Department of Education (DOE) has been feverishly producing data at the request of the tax reform committee. This data forms the material we used to estimate the property tax impact of the LD 1. The analysis is fairly simple. Using DOE data, we determined what each town raised in property taxes for education in 2004-05 and then determined what each town must raise in 2005-06. By then subtracting the FY 06 state education aid identified for each school system under LD 1, a first identification can be made of the municipality's required

local contribution. If the town must raise more money, property taxes are deemed to increase.

An initial issue that should be taken into account is that some of the increases in state aid to education identified in LD 1 is money for certain school systems dedicated to required debt service payments. That portion of any increase in state aid would not be available for general property tax relief. The Windham school system is an example. Unfortunately, we do not have that data from DOE, so we were unable to segregate the dedicated from the undedicated components of the state aid increases.

The DOE has provided data on what each town raised for education in 2004-05. Determining the local costs for 2005-06 was a little more complicated because a projection had to be made for what each town will likely spend on education this upcoming fiscal year. The DOE provided two alternative projections. The first was simply the 2004-05 total school budget increased by 2.5%. This is inflationary type growth and below historical averages. As a starting point, we used these DOE projections.

DOE also provided 2005-06 projections based upon 84% of the operational component of EPS model, which is the amount of the school funding model that the state will recognize in FY 06 under the terms of LD 1. (The other 16% of the operational model will have to be entirely funded with local property tax dollars.) For the 14 communities which are currently below 84% EPS, the EPS-based projections were actually greater than the actual-spending projections.

We estimated that these communities would increase their spending up to the higher state target of 84% of EPS. The reason we did that is that by increasing up to the state target of 84% of EPS, these communities would maximize their state aid next year. For most of these 14 communities there was not a significant difference between the

inflation adjusted number and 84% of EPS. For a couple, such as Sanford, there is a significant difference and our projection must be viewed accordingly.

Another issue is the apportionment of costs and funding among towns that are within SADs and CSDs. As of press time we did not receive the most recent apportionment percentages for the two years in question. Accordingly we are using the best available data; keeping in mind that the data is not perfect.

Furthermore, there is some notable shifting for some SADs and CSDs where one town appears to gain significantly from LD 1 and the other towns within the same SAD would lose significantly. Due to these inter-SAD shifts, the administration is attempting to soften the impacts by phasing them in by some mechanism. We have not yet seen the mechanism and cannot incorporate it into our analysis.

When our analysis is distributed early next week, municipal officials will see that for each community, the "Education" figure represents our estimate of the net impact of changes in state education aid under LD 1 and DOE's estimates of education spending growth. Negative figures are shortfalls that must be made up by property taxpayers. Positive figures should provide a rough estimate of property tax relief, although care should be taken to net-out required debt-service payments.

Revenue Sharing

The revenue sharing calculation was fairly straightforward. First, we took the total amount of revenue sharing as projected for FY 05-06 and ran it through the existing formulas. We then took that same amount of projected revenue sharing and ran it through the proposed formula. The difference is what is reported as a town's gain or loss.

The formulas, Revenue Sharing I and Revenue Sharing II, are currently defined in state law. The only thing that changes under LD 1 is the amount of money passing through each for-

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MediaWatch

Perhaps it is because of the Legislature's rush to enact LD 1 that the media reporting of what the "property tax reform" legislation accomplishes has had glaring examples of inaccuracies. This article will attempt to correct some of the worst.

On Saturday, January 8 the Bangor Daily News ran an editorial concerning the governor's budget proposal for the 2006-07 biennium. The editorial states that the budget plans to "cut property taxes by as much as \$250 million over the biennium" by increasing the state's contribution to public education.

The problem is that much of that \$250 million is double counted. According to the governor's budget proposal, the state provided \$735 million in education aid in FY 05; by FY 07, the second year of the biennium, the governor's budget proposes to spend \$893 million on education aid, a difference of \$158 million. When you also consider that the governor's stated (but undocumented) plan to require that 90% of the new money be used to cut property taxes, the accurate amount by which property taxes might be cut is \$142 million. Keep in mind that the cut would be spread out over the biennium.

Some would like to count the FY 06 increase in education aid of approximately \$90 million twice, once for 2006 and again for 2007. This misstatement should not be parroted by the press. While that type of presentation of *spending* may have some technical grounding, it is misleading to go on to say that property taxes can be cut twice. They can't.

This is like saying you lost 10 pounds because you dropped 5 in 2006 and then maintained that weight in 2007. You didn't lose 10 pounds you lost 5.

On Wednesday, January 12, the Portland Press Herald ran an AP story that had several problems. It attributed to the Governor an assertion that accelerating the "ramp" to 55% from his

preferred 4-year timetable to the alternative 2-year timetable would mean that "property taxes would have to be raised by more than \$70 million." This assertion is inaccurate. There is no obligation for any town to raise property taxes in order for the state to fund 55% of the costs of public education.

What the Governor probably meant was that if the state were to fund 55% of the costs of 100% of EPS, some towns would need to increase their education spending. Some communities, such as Sanford, are currently spending less on education than the new EPS model indicates that they should. In order for Sanford to leverage every penny of state aid it could, Sanford would need to increase its local spending (local taxes). However, there is no obligation that Sanford do so.

Thus, if Sanford, and other "below EPS" towns choose to spend less on education than EPS says they should, these towns would receive less state aid than they could under the new formula. In that case, the amount spent on education statewide would be lower. There is absolutely no reason the Legislature couldn't fund 55% of that lower total bill. And that could be achieved without raising a penny of property taxes.

Lastly, the article references the proposed changes in LD 1 to the circuit breaker program which "supporters say would provide 90 percent of Maine households with relief." This is wholly unsupported. According to the 2000 Census, Maine has 518,200 households (both owner-occupied and rented). For the circuit breaker program to achieve ninety percent penetration, 466,380 households would need to receive relief. This year, approximately 70,000 households received the circuit breaker. The Maine Revenue Service calculated that the expanded circuit breaker in LD 1 would help another 34,000 households, for a total of 94,000. That is 18% of Maine households, not 90%.

Finally, many politicians who sup-

port LD 1 are attempting to sell the public on the idea that this proposal delivers immediate and broad based relief. It doesn't. Between the changes to revenue sharing and education aid, some communities will have additional funds for property tax relief. But hundreds will not, their property taxes will need to increase.

When timelines are unnecessarily condensed, mistakes and misrepresentations become commonplace. The press needs to do a much better job of investigating claims, not just repeating them without any independent verification.

CALCULATING (cont'd)

mula. Under the proposal, \$14.4 more will pass through Revenue Sharing II than would without any changes. Revenue Sharing II favors high mill rate communities.

For each community the Revenue Sharing figure is the net amount that the community would gain or lose by the change proposed in LD 1. A negative is a loss in what state aid would otherwise have been, and that would have to be made up by property taxpayers. A positive is considered direct property tax relief.

Net Impact

Each community's net gain or loss is then determined by adding the education figure and the change in revenue sharing figure. Communities that have a net loss in aid for FY 06 must make up that loss by increasing their tax commitment from the previous year (FY 05) by a corresponding amount. This presented a problem because we don't have the data for FY 05 commitments. Since we do have the FY 03 data, we simply increased those property tax commitments by 2.5% per year to arrive at an estimated FY 05 commitment.

Exclusions

We excluded 6 communities from our analysis for various reasons related to data. They are Glenwood Plantation, Penobscot Nation, Centerville,

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CALCULATING (cont'd)

Codyville Plantation, Passamaquoddy, and Indian Nation.

Summary

We analyzed 486 municipalities in all. According to the analysis, approximately 244 municipalities will need to increase property taxes as a result of LD 1 and 236 municipalities may be able to lower property taxes. Six communities have exactly 0% net impact from the changes in LD 1.

Because some of the impacts are so small, we believe they will be imperceptible to the average taxpayer. So, we have selected an arbitrary but reasonable cutoff points of plus-or-minus 2%. That is, any community having a net impact on their property tax commitment between plus-or-minus 2% will not be able to provide any perceptible property tax relief or tax hike based on LD 1 impacts.

Using these markers, 120 communities will feel no impact, 183 should see tax cuts and 182 should see tax increases.

Obviously, this analysis is fluid and relies upon a variety of data gener-

ated by third parties. The purpose of this project is to provide a reliable demonstration of probable impacts rather than identify with certainty any municipality's guaranteed impacts. Municipal officials who find errors or mistakes in the data should please contact MMA to help improve the analysis.