

City of Paola, Kansas

To: Chairman Marvin Kleeb, House Taxation Committee

From: Artie Stuteville, Mayor

Date: March 4, 2016

Subject: Written Testimony Supporting HB 2609

Dear Chairman Kleeb and House Taxation Committee Members:

On behalf of the Paola City Council, I am writing to express the City of Paola's support for House Bill 2609 which is being considered by your committee. Even though we believe a property tax lid is unwarranted and is an undo infringement on local control, we do understand the political dynamics of the current situation.

As stated numerous times, the tax lid that was adopted in 2015 is totally unworkable and would have serious consequences that would affect community growth and the ability of cities and counties to provide the basic services expected and demanded by their citizens. The proposed Senate bill (SB 316) would be even worse as it eliminates all ability of cities and counties to grow their budgets to meet new community services needs.

Having served as Paola's Mayor for a number of years and also having been a council member involved in preparation of numerous budgets, I can assure you that local government officials receive and listen to input from our citizens. They certainly let us know when they have concerns about our spending, program cuts, or when we raise taxes.

I would ask that you take a few minutes to review the attached "City of Paola Response to Tax Lid Legislation". City Staff prepared this document to give the City Council and the citizens of Paola a comprehensive overview of the issues involved in the tax lid discussion. Several citizens have responded with expressions of support for the City's position. They have also voiced their anger over what they see as "overreach" by the State Legislature and the Governor. Those citizens made it clear that they believe local matters such as budgeting for Paola's needs should be decided by local officials elected by the citizens they represent and not by the State legislature or the Kansas Association of Realtors.

In closing, I once again would like to express the Paola City Council's support for HB 2609. The City of Paola views this piece of legislation a viable compromise that does provide many of the exemptions necessary to properly conduct city operations.

Thank you for your consideration. I know how difficult your position is and how hard it is to deal with the volume of competing agendas.

Sincerely,



Artie Stuteville, Mayor
City of Paola, Kansas



City of Paola Response to Tax Lid Legislation

The Paola City Council and City staff were shocked by the haste with which changes were made to the property tax lid through the passage of Senate Substitute for HB 2109. As additional amendments are being considered, we want to voice our opposition to this obtrusive and unwarranted legislation that provides an unworkable timeline for budgetary elections, determines City budgets by poor metrics, and erodes our representative democracy. We understand that some have made this issue a priority and we recognize that your opposition may not be popular among your colleagues. The following information is provided to help educate you on how dangerous these changes are to our ability to provide services to your constituents.

Importance of Property Tax to Cities

While City property tax comprises 13% of an individual's personal tax liability, property tax revenues for Paola comprise around 30% of our total revenue. Other communities without the sales tax, franchise, and licensing and fees that Paola receives are even more dependent on property tax revenue to balance their budgets.

Four charts have been created to illustrate the importance of property taxes to the Paola budget. Figure 1 shows Ad Valorem revenue over the past seven years (with a cumulative increase of about \$50,000 or 3%). The economic downturn is easily seen starting in 2008 with revenue not reaching 2007 levels until 2014.

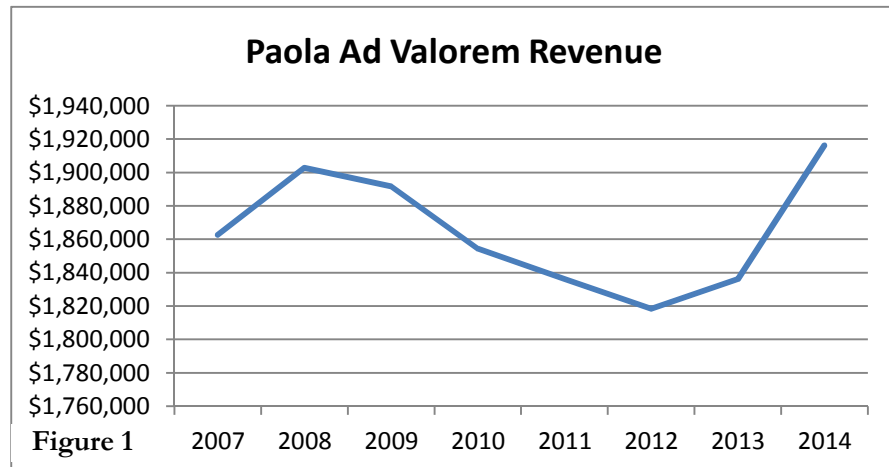
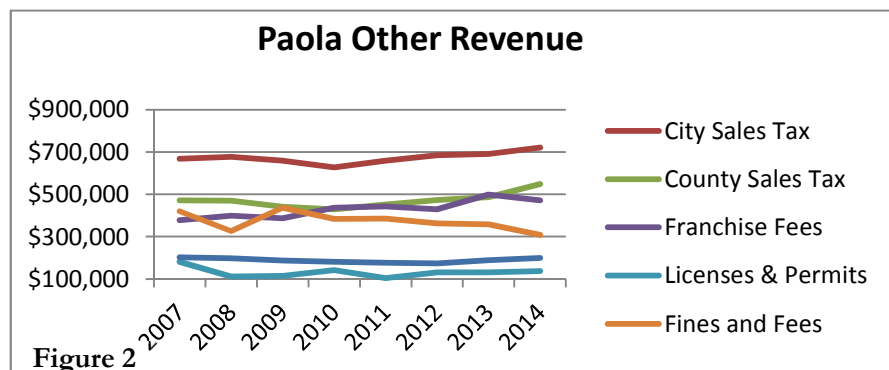


Figure 2 shows other major revenue sources over the same time period. As you can see, during those times of dramatic decreases in property tax revenue, the other revenue streams provide something of a safety net.



Impact of Property Taxes on Median Income Families

For a family of four of median income (\$60,000 per year) living in a home appraised at \$140,000, the City's property tax liability is about 13% of their total tax burden compared to the State sales tax burden at 22%.

The total tax liability for this family is \$5,409. Recipients of this money with breakdown of tax type are as follows:

State Of Kansas: \$2,307
State Income Tax: \$750
State Sales Tax: \$1,211
State Property Tax: \$346

Miami County: \$1,033
County Sales Tax: \$298
County Property Tax: \$735

City of Paola: \$945
City Sales Tax: \$244
City Property Tax: \$701

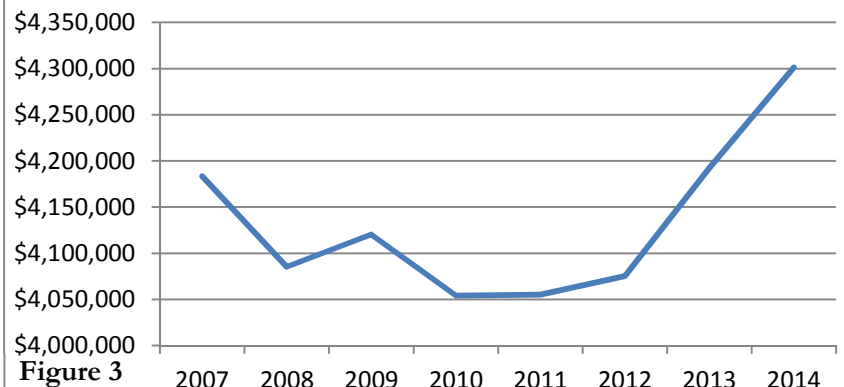
USD 368: \$874
Property Tax: \$874

US Government: \$250

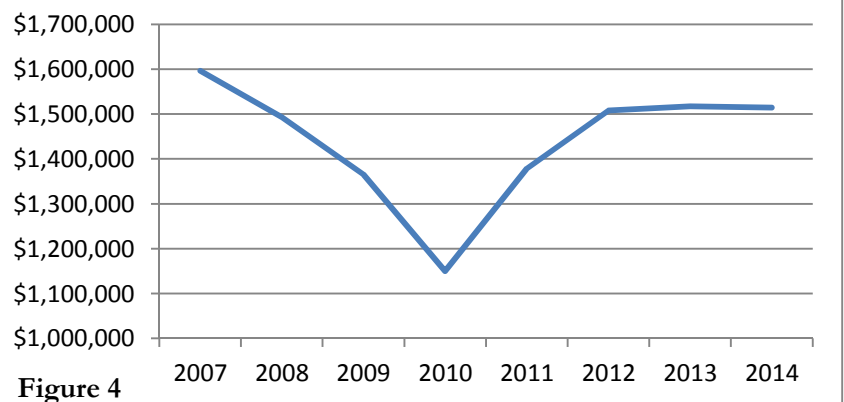
However, as Figure 3 illustrates, these other sources don't compensate for the declines caused by property tax revenue. The City balances its budget in these years by depleting its reserves (Figure 4 of the City's unencumbered cash balance over the same period of time demonstrates this fact). Despite being able to build up cash reserves from their dangerously low levels in 2010, cash balances remain below desired levels of bond rating services and the Government Finances Officers Association.

The property tax rate is the only major factor that cities like Paola can control to make quick and meaningful adjustments to their revenues from year to year. In occurrences like the dramatic decrease in property value or an unanticipated expense, cities rely on their freedom to set the property tax rate to be able to adopt a balanced budget.

Paola Revenue From Major Sources



Paola Unencumbered Cash Balance



Legislative History

Throughout its history, the Kansas legislature had passed various tax lid statutes. The one passed as part of HB 2019 is unique in many ways and is the most problematic. For sake of brevity the last three lid lids are summarized in the chart below. A more comprehensive review of these changes and their impacts is provided in end notes¹.

Tax Lid	Not to exceed	Key Exemptions	Freedom from lid
1989	1989 levy	Bond & interest, employee benefits	Public vote suspension, appeal to state board of appeals, charter ordinance
1999	Next preceding year	Bond & interest	Resolution & majority vote by governing body
HB 2109	Next preceding year + CPI	Bond & interest	Resolution & majority vote by governing body
Senate Substitute for HB 2109	Next preceding year + CPI	Bond & interest	Resolution and vote by majority of qualified electors

Paola's Experience

The City never adopted a budget in excess of the 1989 statutory limits. In a few years' budget discussions, the tax lid was mentioned; however, Paola never chose to pursue any freedom from it. Interestingly, their desire to limit the tax burden was stated as the reason, not the tax lid (they spoke of "chartering out" in a casual way that made it seem routine).

Paola exceeded the 1999 tax lid limit once, during the adoption of the 2010 budget. Due to decreased assessed valuation and lower sales tax revenues the City made every effort to limit expenses including freezing salaries, cutting one patrol officer and one administrative position from the Police Department, eliminating several popular employee benefits (none of which have since been reinstated), and scaling back considerably on capital improvement projects. As mentioned above, cash reserves were also depleted to balance the budget. Interestingly, at the public hearing for the budget

adoption, attendance was low and no comments were given.

Figure 5 shows the adopted budgets for Paola from 2009 to 2015 as compared to the tax limits provided by the 1999 tax lid. As you can see, in most years Paola is under each tax lid, but in the most difficult budget

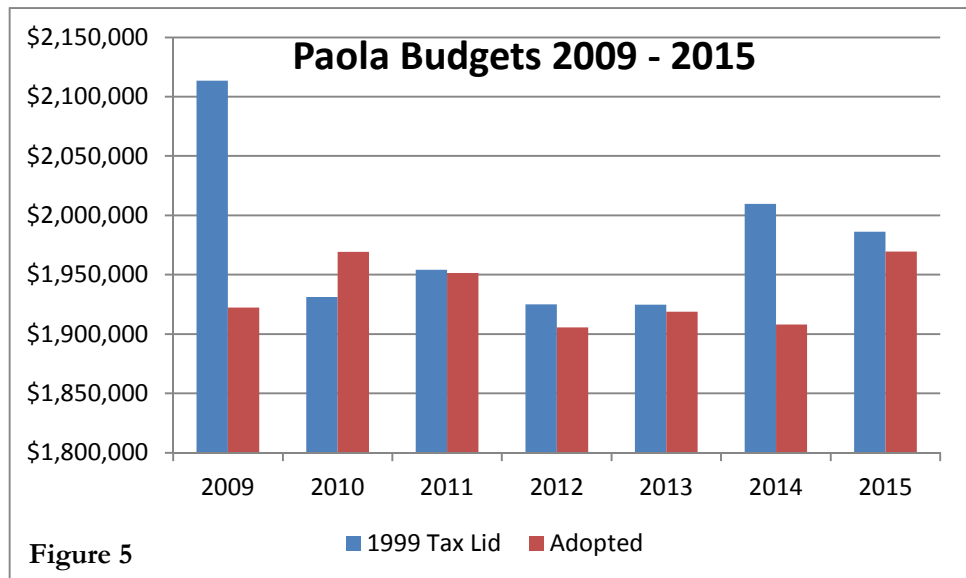


Figure 5

years, that margin becomes uncomfortably thin or nonexistent. This appears to indicate that the City Council is not as concerned with maximizing spending under statutory impositions as they are with limiting the tax burden on their constituents.

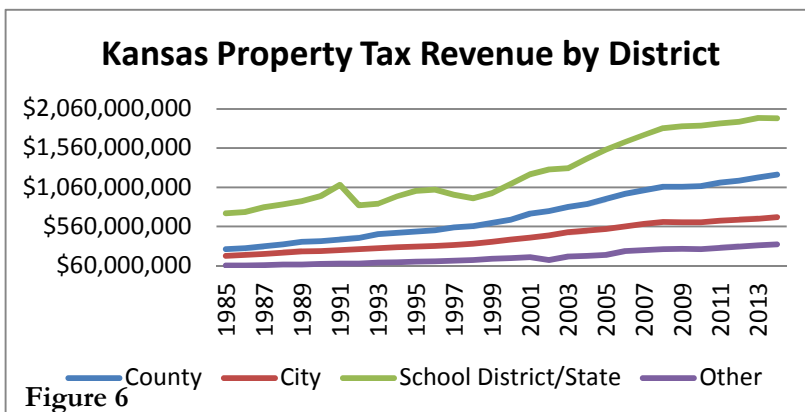


Figure 6

Historical Context for Property Tax Revenue

Figure 6 illustrates property tax revenues by district statewide since 1985. While some have attempted to use recent property tax growth as a rationale for changing tax lid legislation, this chart shows how city and county property tax revenues have grown at steady

rates despite changes in tax lid legislation over the same period of time. The reason for recent increases in property tax receipts is from education related taxing districts. There are many reasons for this increase over this time period. To use this as a justification for this tax lid legislation on all taxing districts is an attempt to fix a problem where it doesn't exist.

Additionally, it is important to note that an increase in property tax revenue is related to an increase in appraised value of property in Kansas. Figure 7 shows the dramatic increase in appraised value since 1997. Thus, an increase in property tax revenue represents new construction and development activities. This is a good thing.

Finally, the infrastructure and public buildings to serve this new

construction is reflected in bond payments for these new and expanded facilities. In Paola, during the late 1990s, bond and interest payments comprised around 40% of the property tax revenue expenditures. In more recent years, they have typically been in the low teens.

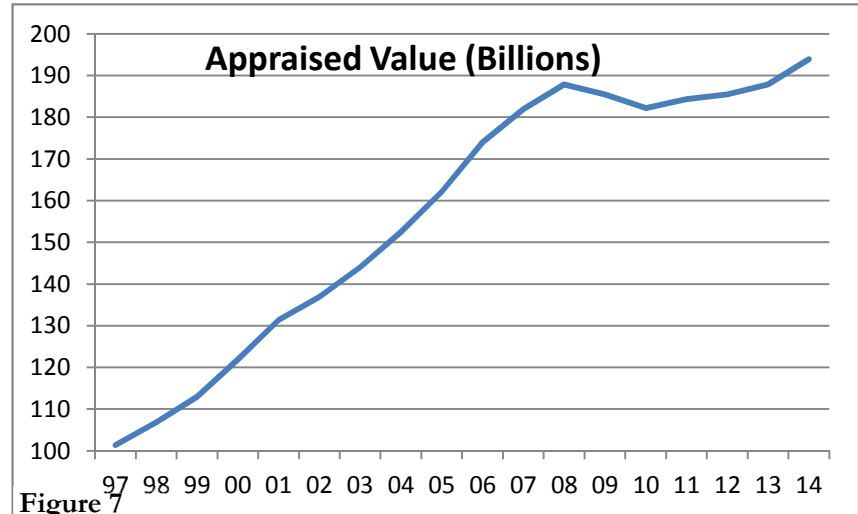


Figure 7

Paola's Concerns with Existing and Proposed Changes to Tax Lid Legislation

1) Use of Consumer Price Index (CPI) as the factor for increase

The CPI is an inappropriate tool for setting tax lids. The CPI is a tool used to measure the impact of inflation. This is done by comparing the cost for a sample of goods commonly purchased by households. The problem of using this number for local governments is that our purchasing habits

are very different than your typical household. For example, most households do not buy asphalt by the ton, PVC pipe by the truckload, and heavy machinery like dump trucks, street sweepers, and excavators. These are major expenses that dramatically impact the expenses of a municipality but are necessary to the operations of a city.

CPI is often used to determine payments for individuals (e.g. Social Security and cost-of-living adjustments) to ensure that the payments provided allow the payee to purchase the same goods despite increases in prices. CPI works well for this purpose. It does not work well in determining whether or not a municipal budget is appropriate.

2) Public vote requirement

The public vote requirement is a radical departure from the Council-Manager or Council-Mayor form of government used by most Kansas communities where the governing body prepares the budget (see K.S.A. §79-2927), provides notice to

the public to receive their input on the proposed budget (see K.S.A. §79-2929), and then adopts the budget (see K.S.A. §79-2930). Thus, under existing statutes, the public is provided an abundance of opportunities to have their voice heard at many open meetings during the budget process.

However, if the City Council is making budget decisions that are in opposition to the will of the voting public, they can be voted out at the next election. This system maintains a high level of responsiveness between the elected officials and the voting public. For instance, in Paola, Council terms expire every two years with half of the Council up for election each cycle (this will change in the near future due to recent legislation presenting other challenges, but that is a topic for another day), meaning that if for whatever reason, the voters feel that the Council is unresponsive to their wishes change can be accomplished swiftly and effectively. Additionally, if the public considers the action to be especially egregious, they may begin a recall process to address the issue immediately.

Removing this authority from the voter elected representatives of the City Council is a non-trivial obstruction of a primary legislative prerogative and erodes our representative democracy.

This is a significant policy change that substantially impacts municipalities without a commensurate level of popular support.

Paola has experienced silence or near silence from the public during recent budget preparations. Few would see this as public sentiment of taxation run amok or a clamor for dramatic changes to budgetary practices and procedures. However, with the way that tax lid legislation was quickly passed without hearings in the last legislative session and is being pushed for immediate adoption, some obviously are hearing voices that are nonexistent in Paola.

Secondly, the logistics of accomplishing the public vote are problematic. Certifying a budget by August 25th after holding an election is infeasible. The timelines are simply too tight. In essence, a municipality would need to anticipate that they might need to exceed the lid and then educate the public of the possible need in advance of an election. However, even if the deadline were extended to some later date to ease some of these pressures, this creates other problems. For instance, by moving the deadline back, municipalities essentially need to prepare two budgets, one if the vote is approved and one if not.

Conclusion

Like the State legislature, Paola is very concerned about being careful stewards of tax receipts. This has been demonstrated in the time and effort dedicated by City staff, Council members and other interested citizens during the preparation and adoption of each budget since 1855.

If the State's interest in passing the tax lid is to protect Kansas taxpayers, this would be better accomplished through other methods. In addition to the information provided earlier regarding

what comprises a median Kansan's tax liability, a compelling argument can be made that tax lids do not actually protect taxpayers.

In a recent study by the American Enterprise Instituteⁱⁱ, one of the oldest and most influential of the pro-business think tanks, on tax and expenditure limits (TEL) states "the central finding reported here is simple and powerful: such measures are not effective (p. 3)." Instead its author suggests that rather than mechanical tools like TELs, that "popular will" exercises control on the behavior of government and that "attitudes must be changed through a process of debate and enlightenment (p. 46)."

Thus, tax lid legislation provides a public relations victory for special interest groups not a protection to tax payers. To achieve this by increasing State control of local government affairs is a poor trade-off. We favor repealing these recent changes and allowing the previous tax lid to remain in place.

The Paola City Council has proven itself better at limiting taxes than obtrusive state regulations. We ask the legislature and Governor to honor their commitment to local control on an issue of such primacy to City governance.

ⁱ 1989 Tax Lid

A state wide assessment of property took place prior to the adoption of this tax lid. The taxing subdivision then chose 1988 or 1989 as a base year to provide a levy limit for future years. This base year was then multiplied by a quotient of the current year valuation by the valuation of 1989 (see K.S.A. §79-5021-5022). Additionally, among other items, levies related to bond and interest and employer contributions for social security, workers compensation, unemployment insurance, health care costs, employee benefit plans, and employee retirement and pension programs were exempted from the tax lid (K.S.A. §79-5028 for full list of exemptions).

Additionally, local governing bodies were given several methods for freedom from the tax lid. This included a suspension of the tax lid for any number of years by public vote (see K.S.A. §79-5029), an appeal to the state board of tax appeals (see K.S.A. §79-5030), or exemption by charter ordinance (see K.S.A. §79-5036).

This tax lid was renewed annually by the legislature with the tax legislation until 1999. At the time of the change, the Topeka Capitol Journal reported that 159 cities and counties had used their home rule powers to charter out of the tax lid legislationⁱ.

1999 Tax Lid

In 1999, as 1989 tax lid legislation was allowed to expire, it is important to note that a tax lid was still in effect. This tax lid prevented raising the tax levy above the next preceding year except for revenue produced by (among other things) new improvements, property that has changed in use, and property that was annexed (see K.S.A. §79-2925b). Local governing bodies were given freedom from the tax lid by adopting a resolution followed by a majority vote.

This formula was recently changed as part of HB 2109 and SB 270 to use the previous year Consumer Price Index (CPI) to determine the allowed increase in revenue.

Changes to take effect January 1, 2018 or sooner

Finally, HB 2109 and SB 270 provide for fundamental changes to the tax lid to take place January 1, 2018 (but some have suggested moving up the date to July 1, 2016). At that time, while the tax lid would then be calculated similarly (again, though some previously adopted exemptions have been suggested to be removed), the procedure for local governing bodies to gain freedom from the tax lid is changed dramatically. As provided by State statute, the only recourse for duly elected local governing bodies to exceed the tax lid is by approval of a resolution by a majority of qualified electors in an August, November, or mail ballot election.

ⁱⁱ Zycher, B. (2013, May). State and Local Spending: Do Tax and Expenditure Limits Work?. *American Enterprise Institute*.