MEMO FROM THE MAYOR

SUBJECT: SO, YOU THINK THINGS ARE A LITTLE WACKY IN D.C., EH?

Bottom Line Up Front: If you're all about DEFUNDING police and fire protection, then you'll love Senator Rice's SB 1021. Police and fire are the services that we fund predominantly from *ad valorem* taxes. What few dollars we have wrested away from general fund to supplement road repair will be gone. Most other alternative sources, federal, state or enterprise funds (sewer and water) cannot be used for police or fire.

This year's legislative session has all the warning signs of a train wreck coming; one that will adversely affect local units of government and, in particular, their ability to properly plan or govern. What's more, it appears the legislature is prepared to blame the wreck on the train and its operators even though the operators followed the rules and the train functioned as designed. Heaven forbid the legislature would look at the train's manufacturer. Indeed, that would mean looking into a mirror. Let me explain.

Essentially, the current property tax system for local units of government operates precisely as designed. Notwithstanding, smaller cities like Emmett typically must still tighten their budget belts every year because the cost of "doing business" often outstrips the fractional increases the cities receive from *ad valorem* funding. Yet, somehow, from the legislature's point of view, cities are out of control. According to the legislature, cities must be reined in; ironically, reined in on a system of the legislature's own creation! Moreover, a creation that barely provides for smaller growing cities like Emmett. To worsen matters, current proposals will make it virtually impossible for cities like Emmett to deal with future growth in any responsible way.

This year, out of all taxes, costs and fees assessed to somebody and received by us, Emmett has a total proposed budget of $8.18 million. Interestingly, this amounts to 2% LESS than last year's budget of $8.32 million. (These figures do not include grants (a/k/a "gifts"), making the final totals $8.27 million this year versus $8.41, last year, but the REDUCTION of 2% in our overall budget remains the same).

How can it be, then, that small, but growing, towns must tighten their budget belts almost every year? Particularly since the legislature contends property taxes are out of control and "something has to be done about it." Emmett's reduction of 2% over last year is simply a function of the "allowance" we received from ALL sources, federal, state and local. As it turned out, this year's allowance was less than last year's allowance. While it is true that property taxes comprise the largest local source of Emmett's budget, we should examine what that really means in the *real politic* of municipal budgeting.

For simplicity, I will refer to the 2018-19, 2019-20 and 2020-21 budget years as simply 2019, 2020 and 2021. In 2019, *ad valorem* taxes received by the city amounted to $1.74 million. 2020 gave us $1.80 million (rounding up) and for 2021, $1.88 is budgeted, which we hope is collected, especially since the county tells us that's what we are entitled to under current formulas.

The jump from $1.74 million to $1.88 million in three budget years is every bit as much attributable to new construction added to the rolls, as an increase in property taxes due to an increase in residential property values. But even at that, the maximum amount Emmett receives in any annual increase is only three percent of the increase in value. Hence, three percent is the maximum increase Emmett will ever receive over the prior year in property taxes under the current system, plus the initial difference of the increase in new construction added to the rolls or subdivisions annexed from the prior year following its placement on the tax rolls. (It takes at least a year, sometimes a little longer, for us to gain the value added. In recent years, the monetary addition from new construction has averaged around $50,000. Hardly an out-of-control moment.

It's no scandal that legislators do little more than pass laws. After all, that is what they are constitutionally designed to do. Gaps in legislative understanding arises, however, because legislators don't "execute" laws. That is the job of the executive under our separation of powers. The separation concept works best when fair-minded citizens fill the various roles. Exacerbating the problem at the local level results from too many legislators never having served in local government, e.g., as county commissioners, city council members or mayors. Thus, legislators do not fully understand the dynamic of how fragile the Idaho funding system is when it comes to generating funds for small cities like Emmett or rural counties like Gem, especially those in the midst of growth. Currently, approximately one-third of the counties in Idaho—some large, some small—are significantly growing.

Currently under consideration by statehouse leaders is a wholesale modification to Idaho Code Section 63-802. The change will radically reduce how cities and counties can reasonably budget or plan for infrastructure needs.

Senate Bill 1021, as currently written, changes the dynamic of computing property taxes for cities (and counties) that starts with the previous year's taxes levied, then adds up to (but never exceeding) a three-percent increase. This formula has been around since the 1970s when Idaho went through its own One-Percent Rebellion similar to California's.

The current formula allows for new construction and annexation values to increase the property tax revenues at the previous year's levy rate, once added to the rolls. Accordingly, in the last three years, as noted above, Emmett's "bonus" payment has amounted to around $50,000, thus making our "payday" a three percent raise, with an additional $50,000 from new construction.

The new formula changes the landscape more than 1969 when we landed on the Moon and the Beatles broke up. The new formula is computed by starting with the previous taxes levied plus the current CPI. Huh? Those of us in the business of managing cities are still trying to wrap our heads around how that could possibly be relevant in growing areas. The one size fits all is all-too-often a failed technique. Even though the proposed formula still allows for new construction and annexation values to increase the property tax at the previous year's levy rates (much like the old) still, the *total* property taxes plus new construction and annexation inclusions, may not exceed 4%. In other words, for growing areas like Emmett, it will no longer be three-percent plus the value added for new construction/annexation from the year before; instead, it caps at 4%.

This new formula will soon leave Emmett behind. We know this because a sister city up north crunched their current numbers under the new formula. Using the 4% cap, Rathdrum discovered that should growth in the community be more than 4%, the effect would be to cut the city's level of service. Rathdrum's technique over the last ten years was to allow new construction so that the burden of maintaining the same level of service did not rest on those already who lived in the community.

Taking the "spreading of cost" away as designed in the "new formula" results in two choices: (1) decrease the level of service or (2) cap growth. Contrary to popular myth, growth does not fully pay for growth whether impact fees are collected or separate development agreements having the effect of impact fees are used. More wear-and-tear happens to existing infrastructure no matter what. Further, impact fees under current law will not cover such increased wear-and-tear on pre-existing infrastructure. Moreover, to cover the cost under separate agreements with the developers will make it impractical for them to build and sell houses.

Before the folks not fully understanding the strategic mistake in capping growth hurt themselves from jumping up and down, consider this: less homes built, results in a shortage of homes available. This, in turn, drives up the assessed value of residential property; thus, this cycle ultimately causes a greater shift in taxes away from business properties to homeowners—once again!

And frankly, this is precisely what this kerfuffle in the legislature is all about—shifting *ad valorem* taxes away from the enhanced values on residential property to agricultural and commercial properties. Agricultural land is lightly taxed compared to residential and commercial properties; what's more, neither ag nor commercial property values are rising as fast as residential values, even in areas of significant growth. That is to say, SB 1021, as with many "governmental solutions", will only make matters worse.

Nevertheless, solutions do exist. Inexplicably, legislators don't want to hear them. First, increase the Homeowners Exemption. (2) Provide additional relief through the Circuit Breaker program. (3) Place a cap on the percentage of taxable market value increase allowed from year to year, simply making sure it did not apply to new improvements or new construction. (4) Offset property tax dollars with on-line sales tax dollars set aside for tax relief. Nobody likes taxes, least of all those of us responsible for assessment, collection and utilizing them. Even so, property taxes comprise a crucial tool in allowing cities to continue delivering services residents expect.