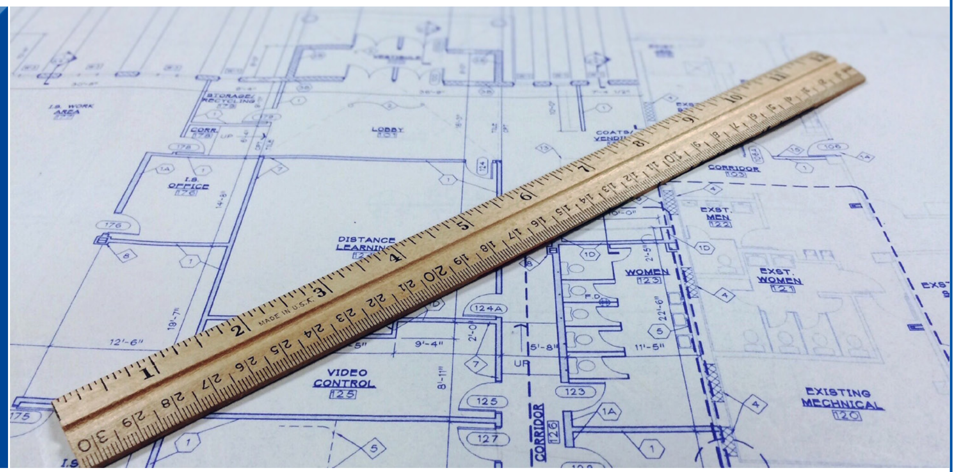
THE WISCONSIN
TAXPAYER



Vol. 86, Number 4 | April 2018

A Growing Divide

Do levy limits lock in disparities in high- and low-growth municipalities?

Since 2006, the state has imposed levy limits on municipalities to slow the growth of local property taxes. A 2011 law change linked the allowable levy increase exclusively to any increases in property values due to new construction. In recent years, this has contributed to a gap in revenues — and spending — between high-growth and low-growth communities in Wisconsin.

The March issue of *The Wisconsin Taxpayer* examined patterns of development since 2005, when the state began imposing levy limits on municipalities. These patterns are important since levy limits tie allowable increases in municipal property tax levies to rates of new construction.

Two important patterns were highlighted. First, statewide rates of new construction have been rising since the end of the 2007-09 recession, but remain below levels experienced when the limits were created. In 2006, new construction averaged 2.8% of total property value statewide; in 2017, that percentage was 1.6%. Second, the distribution of growth has narrowed, with fewer cities and villages experiencing even modest growth. During 2012-16, only 62 of nearly 600 cities and villages averaged new construction rates of 2% per year or more, while 186 averaged 0.5% or less.

This edition looks at the potential consequences of the limits from two perspectives. First, we explore the impact on property taxes. Second, we examine how the limits have impacted municipal budgets, both in terms of overall spending and spending by major function, focusing on the 2011-16 period.

We find that levy limits may have exacerbated the gaps in financial capacity between low- and high-growth municipalities. These limits were first created to slow the growth of property taxes during a period of economic expansion, but they may be making it harder for slow-growing communities to break out of that pattern.

Because of the link between levy limits and new construction, low-growth municipalities may have the fiscal capacity to maintain spending for core services, such as public safety, but not for services that can be more closely linked to new development, such as parks, recreational facilities, and economic development programs. Conversely,

Also in this issue:

WISCONSIN
POLICY FORUM

high-growth municipalities have greater fiscal capacity to maintain or increase spending on core services while also investing in programs that may promote development. While our analysis cannot definitively determine that levy limits are making it difficult for some communities to grow, it does suggest a potential unintended consequence of the design of state levy limits that should be considered by policymakers.

IMPACT ON PROPERTY TAXES

Levy limits, created in 2005, were initially applied to 2006 property tax levies. When first implemented, levy limits were linked to new construction, but a "floor" was established to allow increases of up to 2% for all communities. The floor varied between 2% and 3.86% between 2006 and 2010.

In 2011, the minimums were removed, tying increases in municipal property taxes solely to rates of new construction. In other words, if new construction equals 1.5% of a municipality's total property value, that city or village can increase its property tax levy for operations only up to that percentage. The March edition provides more detail on the creation and mechanics of the limits.

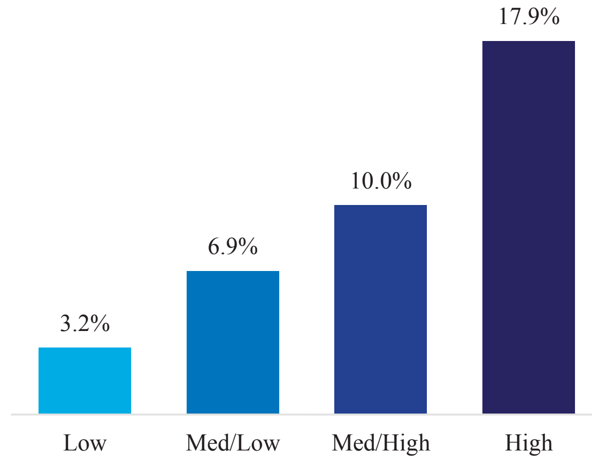
A sharp growth in municipal property tax levies since the mid-nineties was a primary factor in the state's decision to impose levy limits. From 1998 to 2005, prior to the limits, property tax levies increased an average of 5.2% annually, compared to an average inflation rate of 2.2%.

During 2005-11, the average increase in property tax levies declined to 3.7% annually, compared to an average inflation rate of 2.4%. The decline in growth suggests the levy limits were working as intended. However, even slow-growing municipalities were protected by the levy "floors."

When state lawmakers eliminated the "floors" for 2012 levies, slow-growth cities and villages lost that protection. Since then, they have not been able to increase property taxes above the limit, with few exceptions such as for debt service or by successful referendum. Elimination of the floor contributed to a lower levy growth rate of 2.1% annually from 2011-16.

To measure the impact of linking the property tax levy increase exclusively to new construction growth, we group cities and villages into four categories based on average levels of new construction growth. Those municipalities in our low-growth category averaged less than 0.5% annual growth between 2011 and 2016; those in the medium/low category averaged 0.5% to 1.0% annual growth; those in the medium/high category averaged 1.0% to 1.5% annual growth; and those in the high category averaged more than 1.5% annual growth.

Figure 1: Levies Increase by Development Group
Median total growth in property tax levy by development group, 2011-2016



As expected, municipalities with high levels of new construction growth were able to raise their property tax levies consistently (Figure 1). With increased levies comes the ability to maintain, and even increase, service levels. Conversely, slower growth in

THE WISCONSIN
TAXPAYER

April 2018 Vol. 86 Number 4
Publication Number USPS 688-800
Periodical postage paid at Madison, Wisconsin

Subscription Price:
$17.97 per year
Published each month, except July, by the Wisconsin Policy Forum, 401 North Lawn Avenue, Madison, Wisconsin 53704-5033

Postmaster:
Send address changes to *The Wisconsin Taxpayer,*
401 North Lawn Avenue, Madison, Wisconsin 53704-5033
Phone: 608.241.9789 Fax: 608.241.5807
Email: publications@wispolicyforum.org Website: www.wistax.org

levies may impact municipal service levels given the extent to which cities and villages rely on property taxes for revenue. In 2016, nearly 53% of municipal revenue came from property taxes, up from 46.1% in 2005.

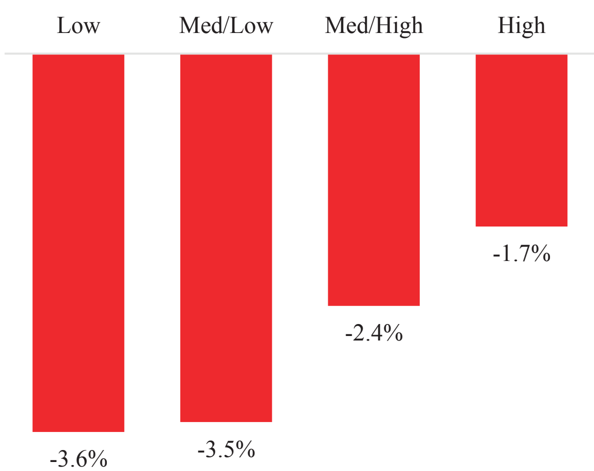
STATE AID ALSO DECLINING

The second biggest revenue source for cities and villages is state aid. During the period in which levy limits were implemented, state aid to municipalities declined.

State aid, which is largely a combination of shared revenue and transportation aids, made up 20.7% of municipal revenue in 2016, down from 26.1% in 2005. Even though nearly all municipalities saw state aid decline from 2011-16, the effect was more pronounced in the low-growth municipalities. Figure 2 shows high-growth cities and villages saw a median state aid decline of 1.7%, while low-growth municipalities received a median 3.6% decline.

It is important to note that declining state aid was accompanied by adoption of Wisconsin Act 10 in 2011. That legislation provided municipal governments with opportunities to at least partially offset aid reductions with increased employee contributions to health care and pension benefits, among other options.

Figure 2: State Aid Declines by Development Group
Median decline in state aid, 2011-2016

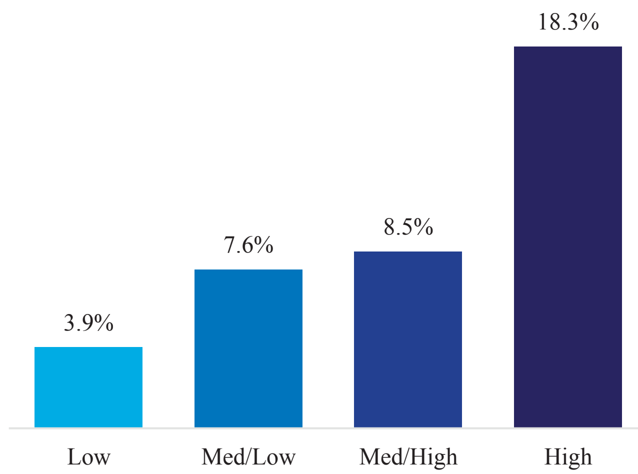


IMPACTS ON MUNICIPAL SPENDING

The limited growth in property tax levies and reduction in state aid had different impacts on different areas of municipal spending. Municipal spending levels are a result of fiscal capacity, which is heavily influenced by allowable levies. This spending may also contribute to new construction and development. Growth in development may lead to an increase in new construction, which, in turn, leads to an increase in the allowable levy. Without new construction, municipalities are locked into flat property tax levies and spending levels.

We analyze median total spending increases from 2011 to 2016 for each group of municipalities based on new construction. For those years, the high-growth municipalities increased median spending by 18.3%, while the slow-growth cities and villages spent 3.9% more, as shown in Figure 3. To further understand municipal spending patterns as they relate to new construction, we look at several different categories, detailed in the gray box on page 4.

Figure 3: Total Spending Increase
Median increase in total spending, 2011-2016



Public Safety

Public safety is perhaps the highest priority for municipal leaders, accounting for about 20% of annual spending in most cities and villages. We break public safety spending down into two separate categories: police, which includes all law enforcement and corrections spending; and fire, which includes all fire prevention and emergency medical services (EMS) spending.

As cities and villages grow, one would expect spending on police, fire, and EMS to rise as well, given that increased development may produce increases in the labor force and population. Additionally, we expect slow-growth municipalities to at least maintain public safety spending levels due to the necessity of such services.

Figure 4 shows growth in development was indeed accompanied by a rise in public safety expen-

Expense Categories

Public Safety - Police and fire combined

Police - police, law enforcement, corrections, and public safety, capital outlays

Fire - fire protection and emergency medical services, capital outlays

Transportation - local road maintenance, local road construction, limited purpose roads, and state highway maintenance

Parks and Recreation - library, parks, museums, recreational programs, zoo, facilities, and other

Development - urban development and economic development

ditures. From 2011-16, median spending on public safety in low, medium/low, and medium/high-growth municipalities increased between 6.2% and 9.1%, while high-growth communities spent 16.1% more.

The disparity in spending increases is not surprising, considering that more growth in both development and population requires more public safety services. Areas experiencing higher levels of new construction growth also are more capable of raising property tax levies to maintain needed funding levels for police, fire, and EMS.

Transportation

Transportation expenditures include maintenance and construction of local roads and highways. For this function as for public safety, we find that high-growth municipalities experienced greater median spending increases than their lower-growth counterparts.

Major transportation costs are often paid for through municipal borrowing, sometimes through the use of tax increment districts (TIDs). A TID is a tool used by municipal governments to spur development by earmarking property taxes resulting from that development to pay for infrastructure improvements. As we noted in the previous issue, nearly half of the high-growth municipalities created at least one TID between 2011-16, compared to 12% of lower-growth cities and villages that created one during the same time period. New development, especially in TIDs, often requires significant transportation-related spending, such as new or expanded roads as well as access to major highways.

Consequently, it is not surprising that Figure 5 shows differences in transportation spending between municipalities with different levels of new construction growth. From 2011-16, median transportation spending rose 0.4% in low-growth municipalities while increasing 6.9% in high-growth cities and villages. The difference suggests either new development spurred investment in transportation infrastructure, or such investments attracted development. However, we do not draw a causal link between transportation spending and development growth because other factors may impact road construction and maintenance.

Figure 4: Public Safety Spending in High Growth Areas Outpaces All Other Areas
Median increase in public safety spending 2011-2016

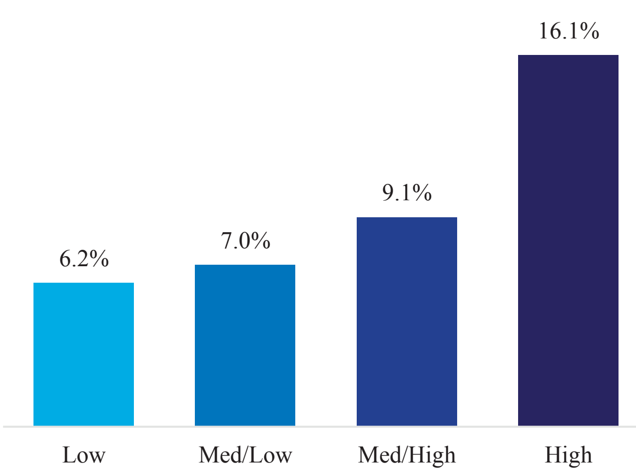
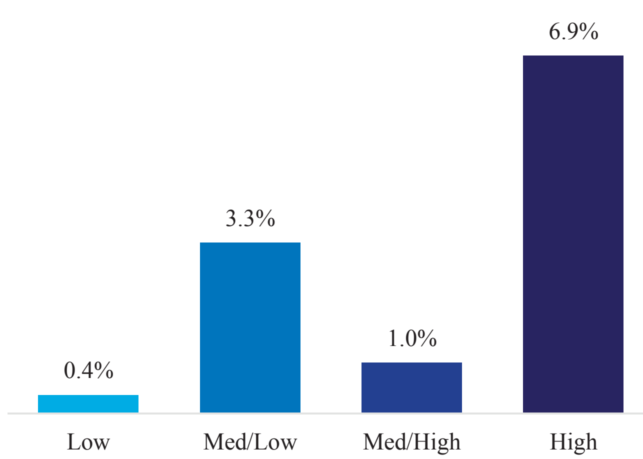


Figure 5: Transportation Spending Increases as Development Increases
Median increase in transportation spending 2011-2016



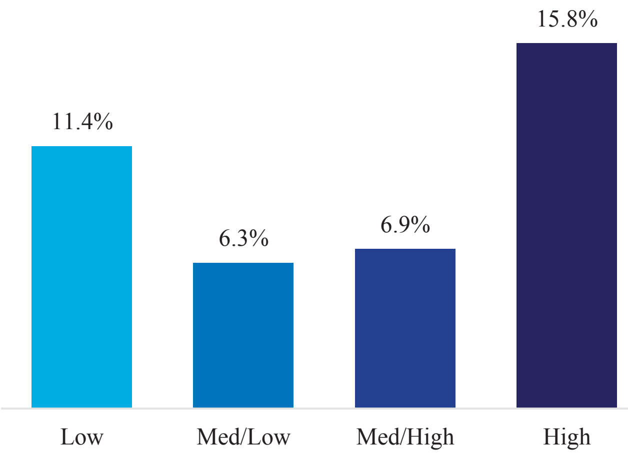
Parks and Recreation

Parks and recreation expenditures include spending on libraries, parks, museums, recreational programs, zoos, and park facilities.

Increased development, especially with the implementation of TIDs, normally is accompanied by an increase in the local labor pool. Employers often cite public parks, bike trails, and green spaces as necessary amenities to attract and retain employees. This desire may produce an increase in parks and recreation spending. Consequently, we might expect high-growth municipalities to increase spending on parks and recreation more than low-growth areas. It is also important to note that low-growth municipalities may lack the funds to increase spending on parks and recreation.

The data appear to bear this out with regard to high-growth municipalities, as shown in Figure 6. But on the other hand, low-growth communities spent more than the two medium-growth communities.

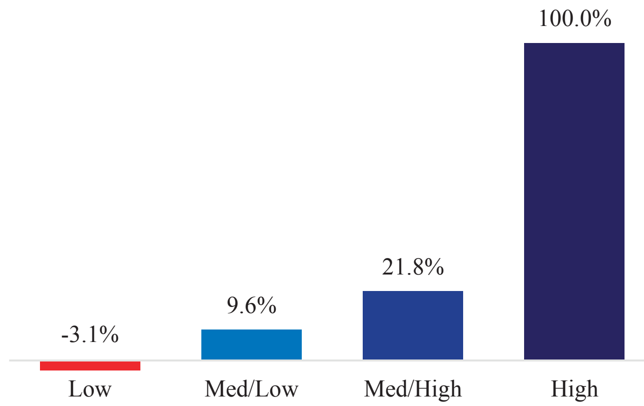
Figure 6: Parks and Recreation Spending Increases
Median increase in parks spending, 2011-2016



Development

Development spending at the municipal level is a combination of two spending categories: economic and urban. Economic development is spending that spurs growth, such as advertising the advantages of a municipality, providing financial assistance to new businesses, and aiding acquisition and development of industrial sites. Urban development includes expenditures for the rehabilitation of deteriorated neighborhoods, the acquisition of property, and the cost of relocating and rehousing people displaced by redevelopment projects. New construction, and by extension any increase in property tax levies, requires new development. Municipalities also may be able to foster new development through expenditures in this category.

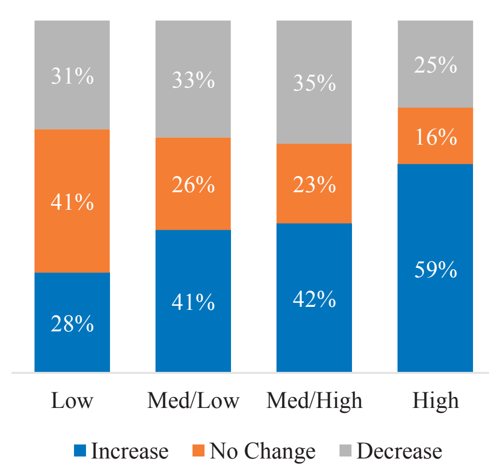
Figure 7: Development Spending Increases
Median increase in development spending, 2011-2016



Development spending, perhaps more than any other type, significantly differs between growth groups. Figure 7 shows that between 2011-16, median expenditures decreased for low-growth municipalities by 3.1% while doubling in high-growth communities.

Considering median development spending by high-growth municipalities has been significantly higher than all other groups, we take a closer look at patterns of cities and villages within each category. Figure 8 shows a relatively consistent share of communities in each category decreased development spending. However, in the high-growth group, 59% of municipalities spent more on development, while

Figure 8: Development Spending
% of muni's that changed development spending, 2011-2016



just 28% of slow-growth cities and villages increased spending. Essentially, increased development spending is concentrated among the high-growth group, while low-growth groups are either maintaining or decreasing levels of development spending. This shows that spending on economic and urban development either attracts new development or at least accompanies it. Either way, growth gives municipalities the ability to raise property tax levies.

Impact of Population

In addition to development, population size may have an impact on spending. In order to account for population differences, we examine the same development groups separated into municipalities with either more or less than 5,000 residents. We find municipalities with larger populations increased spending in nearly all categories by more than those with fewer residents, regardless of the level of new construction growth, except in the case of parks and recreation and development spending.

Municipalities in most growth categories maintained similar spending patterns on parks and recreation, regardless of population. However, that trend does not hold in low-growth communities. In the lowest growth category, municipalities with fewer than 5,000 residents increased spending by a median of 12.3%. But in slow-growing communities with more than 5,000 residents, median spending increased just 0.2%.

Figure 9: Parks and Recreation Spending Varies by Population
Median increase in spending by population, 2011-2016

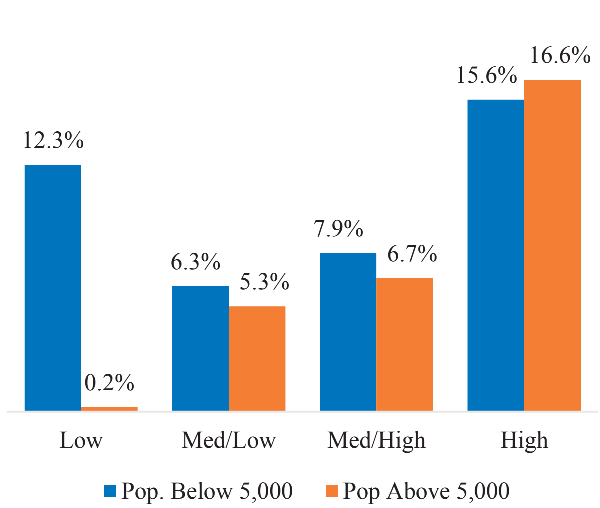
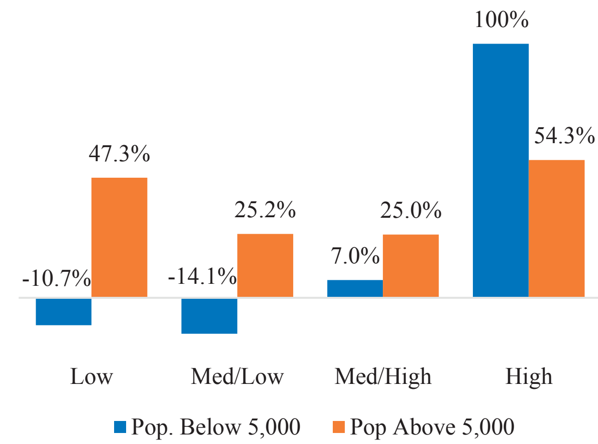


Figure 10: Development Spending Varies by Population
Median increase in spending by population, 2011-2016



The significant difference shown in Figure 9 suggests that low-growth, high-population communities may have shifted spending away from parks and recreation into other areas. Indeed, nearly half the low-growth municipalities with more than 5,000 residents decreased spending in this category between 2011 and 2016.

Population, regardless of new construction growth, may also be linked to development spending. Figure 10 shows from 2011-16, low-growth municipalities with fewer than 5,000 residents decreased development spending by a median of 10.7%. However, when only accounting for municipalities with over 5,000 residents, development spending instead increased by a median of 47.3%.

Essentially, low-growth, high-population municipalities increased development spending, even without new construction. Conversely, high-growth, high-population communities increased spending less than their low-population counterparts. The difference suggests while development and new construction are linked, population size doesn't always drive development spending.

OBSERVATIONS

State-imposed levy limits tied to new construction, which were implemented during a time of economic growth, appear to have locked many municipalities into certain spending patterns. Declining state aids and the absence of other significant revenue sources have made all municipalities more reliant than ever on the property tax. However, the linkage of levy limits to new construction, and the removal of levy "floors," may have contributed to different municipal spending patterns that are being perpetuated by the caps.

Faced with flat or declining state aids, municipalities may be experiencing fiscal challenges regardless of the level of growth. When factoring in flat or slow-growing levels of new construction that place limits on their levies, many municipalities are facing increasingly difficult budgets. Ultimately, finite resources may force slow-growing cities and villages either to decrease spending in certain areas, or reallocate spending from non-essential categories to core services.

Our research shows that municipalities, regardless of new construction growth, have increased spending on public safety, which is perhaps the most essential municipal service. Even low-growth municipalities increased spending on police, fire, and EMS. Spending growth was much larger in high-growth municipalities, which is to be expected given how population and development drive the need for additional public safety services.

When factoring in flat or slow-growing levels of new construction and limits on their levies, many municipalities are facing increasingly difficult budgets.

Given the fiscal constraints placed on municipalities, especially those with low development rates, an increase in public safety spending may come at the expense of other, non-essential services. Transportation, parks and recreation, and development spending all increased at a much lower rate in low-growth municipalities compared to high-growth cities and villages. In fact, driven in large part by low-population communities, median development spending among low-growth municipalities actually decreased from 2011-16.

Our research cannot definitely prove that lower municipal spending impedes new construction growth and locks low-growth communities into that pattern, but the current trends may still be a cause for concern.

Given the fiscal constraints placed on municipalities, especially those with low development rates, an increase in public safety spending may come at the expense of other, non-essential services.

Reduced spending on transportation may delay road construction, or lead to short-term road repairs instead of major rehabilitation.

Lower development spending may cause a municipality to appear less attractive to prospective businesses, thereby further reducing new construction. Reduced spending on parks and recreational facilities may impact population growth as well as the ability to attract new employers.

SUMMARY

Municipal property tax levy limits have not constrained either high- or low-growth communities from maintaining spending on core services such as public safety. However, a lack of new development (and consequently, new revenues) may be making it difficult for low-growth municipalities to spend more on programs and services that could attract new development. This, in turn, might contribute to a loop: levies continue to stagnate, communities become less attractive, and they continue to experience less development.

Meanwhile, high-growth municipalities have been able to increase levies, allowing them to maintain and increase spending on both essential services and those that may attract new construction. This could create a different effect: spending increases in development, transportation, and parks and recreation may spur growth, which then allows those municipalities to increase levies. More revenues in turn provide cities and villages with more financial capacity to further attract new development.

Our research suggests that levy limits may have contributed to a growing gap between high- and low-growth municipalities. Policymakers may want to consider this possibility as they weigh the pros and cons of new construction-based levy limits in the next state budget. ☐

Wisconsin Policy Forum
401 North Lawn Avenue • Madison, WI 53704-5033
608.241.9789 • www.wistax.org

PERIODICALS
USPS 688-800

POLICY NOTES

■ **Supreme Court Raises Pay for Court-Appointed Lawyers.** The Wisconsin Supreme Court voted on May 18 to raise the rate of court-appointed private defense attorneys from $70 to $100 per hour. Currently, the state Public Defender's office pays private lawyers $40 per hour – the lowest rate in the nation – to handle criminal cases for indigent clients. The Legislature set that rate in 1995. When the Public Defender's office cannot find an attorney for defendants, judges can appoint private lawyers at the new, higher rate. Judges appoint private lawyers in order to prevent individuals from spending days or weeks in jail awaiting court proceedings. The court stopped short of deeming the public defender rate "unreasonable," and did not index future pay increases to the rate of inflation. Since court-appointed private lawyers are paid for by counties, some are concerned about the cost shift to local governments. Estimates put the cost to counties at $32 million. Potential unintended consequences may be that fewer lawyers will take on public defender caseloads, and instead will hold out until appointed by a judge for more than twice the hourly rate.

■ **New Jobs Numbers**. Wisconsin added 13,700 manufacturing jobs from April 2017 to April 2018, and ranks 3rd nationally for the number of manufacturing jobs added so far in 2018. According to the Bureau of Labor Statistics, the state's labor force participation rate increased to 68.9%, which is 6 percentage points higher than the national rate. Additionally, Wisconsin's record-low 2.8% unemployment rate is the lowest in the Midwest, and 5th lowest in the nation.

We are moving to digital!
Please register your email to stay up-to-date on our latest research, events, and more.

wistax.org/join

■ **Chronic Wasting Disease (CWD).** Gov. Walker (R) has announced three measures to contain the spread of CWD: prohibiting the movement of live deer from any of the 53 CWD-affected counties; requiring additional fencing for each of Wisconsin's 376 registered deer farms; and banning the movement of deer carcasses from CWD-affected counties. CWD has been linked to population declines in deer herds but to date it has not been shown to affect humans. Wisconsin DNR found CWD-infected deer died at three times the rate of uninfected animals.

In FOCUS . . . recently in our biweekly newsletter

- AFRs & CAFRs, Surpluses and Deficits (#6-18)
- Foxconn could bring big changes to transportation, transit (#7-18)
- Is municipal debt rising too fast? (#8-18)
- New CBO report raises concerns for deficit, federal aid (#9-18)
- Local governments turn to "wheel taxes" as other revenues lag (#10-18)

The Wisconsin Taxpayer is published by the Wisconsin Policy Forum. The Wisconsin Policy Forum was created on January 1, 2018 by the merger of the Madison-based Wisconsin Taxpayers Alliance and the Milwaukee-based Public Policy Forum. Throughout their lengthy histories, both organizations engaged in nonpartisan, independent research and civic education on fiscal and policy issues affecting state and local governments and school districts in Wisconsin. WPF is committed to those same activities and that spirit of nonpartisanship.