To: MMA's Executive Committee
MMA's Legislative Policy Committee
Key Municipal Officials
Fr: Geoff Herman
Re: Preliminary Analysis of Governor LePage's Proposed State Budget
Date: January 14, 2013

Last Friday afternoon, the state budget being proposed for the next two fiscal years was released by Governor LePage, along with the proposed supplemental state budget for the current fiscal year (FY 13). Between them, the proposed budgets either completely break or seriously violate nearly every significant financial agreement that has been struck over the last 80-plus years between state and local government as currently codified in statute, including:

- The motor vehicle excise tax system established in 1929
- The municipal revenue sharing system established in 1972
- The "circuitbreaker" property tax relief program established in1987
- The property owners' Homestead Exemption established in 1998
- The "55%" education funding directive established by the voters in 2004
- The business equipment tax exemption system established in 2008

Unless substantially amended by the Appropriations Committee and the full Legislature, this proposed budget will strip $420 million over the next two years either from municipal government directly or from the property taxpayers that support municipal government. The resulting cuts in local services or increases in property taxes that will necessarily result if the Governor's proposals become law can only be described as extremely serious.

What follows is our preliminary review with the property tax proposals listed and analyzed according to some rough order of magnitude, taking into account both the fiscal and the public policy impacts.

Municipal Revenue Sharing. The biggest injury to the towns and cities is the Governor's proposal to completely eliminate the distribution of municipal revenue sharing beginning in July 2013. That proposal would discontinue the distribution of $283 million in property tax relief funds over the next two year period ($139 million in FY 14 and $144 million in FY 15) and use that money to fund state government. Because this Governor and his predecessor, in concert with the previous two legislatures, have been regularly raiding the revenue sharing program to the tune of $40 million a year, the Governor's press description identifies the municipal impact as $200 million over the biennium rather than the nearly $300 million it really is.

K-12 Education Funding. The Governor's proposed 2-year budget includes a lot of new programmatic language concerning state funding for public K-12 education, but the bottom line is flat funding for the schools at the state's current 45% contribution ($895 million) toward the $2.085 billion Essential Programs and Services school funding model (EPS). That said, this proposal delivers even less than flat funding in real life because it also requires the school systems for the first time in history to pay for 50% of the annual "normal cost" appropriation for the teachers' retirement premium.

The projected annual "normal cost" amount for each year of the biennium is approximately $29 million, to be split roughly 50-50 through the mechanism of adding that normal cost to the EPS model. In essence, this new forced financial participation effectively removes $14 million in normally available resources for direct educational programming by requiring the local school systems to contribute that amount toward a teachers' retirement program the local governments had absolutely no say in designing.

Even deeper than the financial impacts is the damage done to the state-local trust factor and how the proposal further mangles the directive adopted by the voters in 2004 calling for the Legislature to provide 55% of the EPS model from the state's General Fund. Not only is the state fully 10 percentage points – or $200 million each year -- below the voters' directive, the EPS school funding model upon which the 55% standard is based and related statutes are now undergoing annual legislative manipulations designed to weaker the 55% as adopted by the voters.

Other proposed changes to the EPS model in the Governor's budget include:

- Reducing the minimum school subsidy calculation for low receiving school systems from the original 5% of EPS factor to a 2% of EPS factor;
- Reducing the obligation for every school system to be provided at least 100% of the school special education costs (as adopted by the voters in 2004) to just 25% of those costs, which also targets "low receiver" school systems; and
- Reducing the adjustments in the EPS model for economically disadvantaged students by applying a 98% reduction factor in the first year and a 95% reduction factor in the second year.

General Assistance. The Governor's proposals to restrict access to the General Assistance program begin in his proposed supplemental budget for the current fiscal year (FY 13) and then continue more broadly and deeply in the proposed biennial budget.

In the proposed supplemental budget for FY 13, the Governor is proposing to cap the state's reimbursement obligation at the $10.2 million currently appropriated for that purpose. As soon as the state runs out of reimbursement funds under the cap, all municipalities would be authorized to discontinue their General Assistance programs. This cap is not being proposed just for the current fiscal year, however. It would become a permanent annual cap as a matter of law, meaning the GA program would start up throughout the state every July 1, but potentially sputter out in municipalities across the state as each fiscal year progresses and the reimbursement appropriation, whatever it happens to be in a given year, runs out.

Adding onto that proposal in the two-year budget, the Governor is proposing to:

- Eliminate the enhanced "90%" formula established 30 years ago that reimburses municipalities for benefits issued over a certain threshold related to the municipality's valuation, thereby establishing a flat reimbursement rate of 50% regardless of expenditure level. This proposal delivers a targeted negative impact to the state's largest service center communities;
- Provide no reimbursement to any municipality with respect to housing benefits issued to a homeless shelter that exceed $10 per day;
- Deny GA eligibility altogether to all the people in any household that was formerly receiving the state-federal TANF benefits (Temporary Assistance for Needy Families) if the household is no longer receiving those TANF benefits because the household reached the 60 month lifetime limit or the adults in the household are being sanctioned for breaking program rules.

The net effect of these proposals is estimated to save the state treasury $3.1 million in FY 14 and $3.6 million in FY 2015. The state's financial advantage translates directly to financial disadvantage on the municipal side, targeted to the largest regional service centers throughout the state (Portland, Lewiston, Bangor, Caribou, etc.).

Homestead Exemption. Manipulated many times since first enacted in 1998, the property tax Homestead Exemption currently subtracts $10,000 from the assessed value of the primary home of all Maine residents. 50% of the lost tax revenue associated with the exemption is paid to each municipality by the state. The other 50% is effectively paid for by the taxpayers within the municipality through an increased property tax rate. The reimbursed value of the Homestead Exemption costs the state $24 million each year.

The Governor is proposing to eliminate the existing Homestead Exemption and replace it with a $20,000 homestead exemption, but the program would only be available to "homesteaders" who are 65 years of age or older.

There are well over 300,000 Maine homesteads currently receiving the benefit of the exemption. The mathematics of the funding impacts as projected by the Administration suggests that approximately two-thirds of those homesteads would be eliminated from the program under this proposal. Because the value of the Homestead Exemption would be doubled for the new program's elderly beneficiaries, the state savings would be just over $9 million each year. Although the proposal would enhance the property tax benefits for elderly Mainers, it will simultaneously increase property taxes for over 200,000 Maine homesteaders by approximately $120 per year on average.

Circuitbreaker Program. Similar to the reduction proposed for the Homestead Exemption, the Governor's proposed budget would eliminate the "circuitbreaker" property tax and rent relief program for all beneficiaries except those who are 65 years of age or older.

In addition to the new age limitation, the proposal includes additional restrictions:

- The maximum annual income levels would be reduced from $60,000 to $38,200 for a single-person household and from $80,000 to $59,300 for a multi-person household;
- The percentage of annual rental payment used to calculate the level of benefit would be reduced from 20% to 15%;
- Applicants with a level of investment income exceeding $10,000 would be ineligible to receive benefits.

Under current law, $43 million is provided annually to about 90,000 circuitbreaker households (58,000 homesteads, 32,000 renters). By limiting this program to only the elderly applicants, and by further limiting the program to even that population, it appears that about 85% of the current circuitbreaker program would be gutted under this proposal. The budget documents indicate the state would save (and the property taxpayers and renters would lose) from $35 to $38 million each year of the biennium, or $73 million in total.

State Appropriation of Truck Excise Tax Revenue. In the area of the Highway Fund, the Governor's budget is proposing to supplement the revenues that support state road and bridge projects by requiring municipalities to give over to the state treasury some of the money collected through the motor vehicle excise tax. The specific proposal would require all excise tax revenue related to "truck tractors" (trucks that pull trailers) to be collected locally, as is currently the case, but then given over to the state. The proposal estimates an annual municipal loss (and state gain) of $4 million a year, or $8 million over the biennium.

Conversion of BETR to BETE. The next proposal in the gauntlet of changes that would negatively affect municipal government will be of particular concern to municipalities with significant amounts of personal property in their tax base.

In 1995, the Business Equipment Tax Reimbursement program (BETR) was implemented, under which businesses paying property taxes on their machinery, equipment and other business personal property first installed after April 1, 1995 were fully reimbursed by the state for their taxes paid.

In 2008, the Business Equipment Tax Exemption program (BETE) was created, under which the same types of commercial/industrial personal property first installed on or after April 1, 2008 were made exempt from taxation altogether, with the affected municipalities receiving from the state 50 cents on the dollar for their lost tax revenue as minimally required by the state Constitution.

As proposed in the Governor's two-year budget, the personal property first installed between 1995 and 2008, which is now governed by the BETR program, would become completely exempt under the BETE program. Instead of the municipalities receiving full tax revenue and the businesses then being reimbursed, the municipality would receive no tax revenue from the businesses and 50% of the lost tax revenue would be provided by the state. (Within this proposal's details, the reimbursement rate would be 60% in the first year of implementation, 55% in the second year, and the 50% constitutional minimum thereafter.)

One type of business property that would not be eligible for the BETE exemption under this proposal is the personal property of businesses that are primarily retail establishments.

The state's annual BETR reimbursement obligation is currently approximately $50 million. Straight math would suggest that converting a full-tax reimbursement to a 50% reimbursement would save the state and hurt the municipalities to the tune of $25 million a year. The budget's fiscal analysis, however, suggest that eliminating the full tax reimbursement to the businesses and replacing it with a 60%-sliding-to-50% reimbursement obligation to the towns will "save" the state about $12 million a year, which the towns will lose. That impact would not be implemented until FY 15.

"Sudden and Severe Disruption". It is unclear why this final property tax related issue is found in a budget bill and not dealt with as a separate administrative proposal, but the Governor's proposed budget includes a sweeping redesign of the "sudden and severe disruption" statute. That law was enacted in the late 1990s and allows for an expedited change in a municipality's state valuation -- and in some cases an expedited change in school subsidy – when a major local taxpayer shuts down or significantly downsizes, typically an industrial concern in an otherwise small community.

In summary, the changes would: (1) disallow eligibility for a mere abatement action by restricting eligibility to circumstances of business cessation, property removal or property destruction; (2) restrict the benefits of the reduced state valuation to the subsequent fiscal year; (3) require a third-party "professional appraisal" to support the elements of the application alleging valuational loss; and (4) be made to apply "retroactively" to the tax year beginning on April 1, 2013.

The requirement of a "professional appraisal" is also included in the Governor's budget proposal to apply to certain communities who claim eligibility for an enhanced reimbursement under the BETE program, as allowed by statute, because they have or had much higher than average amounts of personal property in their tax base.

Next Steps. The public hearings on the Governor's proposed budget will not begin for several weeks. During that interim period, MMA's advocacy staff hopes to work with municipal officials from across the state to develop accurate information about the impacts for each town and city and convey that information to all legislators. Over the course of the next week, MMA will be assembling and disseminating information on a town-by-city basis about the revenue sharing losses, the number of homesteaders and circuitbreaker recipients who would lose benefits, the General Assistance impacts, the tax revenue impacts associated with the BETR-to-BETE conversion, etc.

The Governor's proposal delivers a double whammy to all property taxpayers in this state by first jacking up the property tax rate in a variety of ways and then eviscerating the programs that are designed to help people who are having trouble paying their property taxes. Working together, municipal officials will make a strong case to the legislators to reject this extraordinary overuse of the most regressive tax in Maine's tax code, the property tax.