

SALES TAX PROSPECTS REPORT, 2011 FORWARD

2011 Status

As the County Board prepares to address plans for the half-cent sales tax, it is important to understand the facts about the current situation. With each County Budget since 2007, the policy has been to use an increasing amount of sales tax revenue as a way to fund county operations and restrain property tax levies. County financial plans, as reflected in the capital program through 2016 and in the assumptions inherent in the 2011 Budget, have assumed that the county sales tax will continue. This policy direction was clearly stated when the County Board decided in 2006 to require a formal review of the sales tax in 2011. The consensus then was that a second review would be worthwhile to assure that the sales tax implementation had achieved the financial goals intended. It is for this reason that the first report, completed March 22, focused on accountability. For 2011 it is expected that \$8.5 million will be collected, budgeted conservatively relative to the 2010 actual collections of \$8.6 million. The purpose of this report is to look at several aspects of the consequences of changing direction and ending the sales tax at the end of this year.

Sales Tax Applied to Levy or Not

The amount budgeted as an offset to the property tax levy in the operating budget is a product of the estimated total sales tax collections and the percents allocated for operating offset and for capital projects. The current capital improvement program plans to use 35% of available sales tax revenues for capital projects, and the remaining 65% for operating offset in the years 2012 – 2016. We need to cautiously assume that the economic slowdown will persist and that sales tax collections will not grow as fast as in earlier plans. The table below is one scenario that illustrates a pattern like that.

| YEAR | SALES TAX \$ | CIP % | CIP \$ | Offset % | Offset \$ |
|------|--------------|-------|-----------|----------|-----------|
| 2012 | 8,700,000 | 35% | 3,045,000 | 65% | 5,655,000 |
| 2013 | 8,800,000 | 35% | 3,080,000 | 65% | 5,720,000 |
| 2014 | 9,000,000 | 35% | 3,150,000 | 65% | 5,850,000 |
| 2015 | 9,200,000 | 35% | 3,220,000 | 65% | 5,980,000 |
| 2016 | 9,400,000 | 35% | 3,290,000 | 65% | 6,110,000 |

What would happen to the county operating budget if there was no sales tax in 2012? The proposed state budget for 2012 has very tight limits on increasing county property tax levy, equal to the percent of growth in net new construction values or zero, whichever is greater. For this report, let's assume that no increase in property tax levy will be allowed. If the total budget for 2012 would be the same as 2011 for a similar scope of operations, this will mean that more than \$5.6 million of county expenses would need to be cut from the proposed budget to deal with the loss of the sales tax funding source. To put this in context, this would be about a 12% cut to every department's levy; or one-third of the Sheriff's Dept. levy; or half of the Human Services Dept. levy; or the entire levy for both the Highway Dept. and Clerk of Courts combined.

Capital Projects Funded by Sales Taxes or Borrowing

The capital program funded by sales tax has been the method for addressing ongoing maintenance and improvements in the county highway system, county parks, county facilities, and buildings and grounds at Fair Park. In addition to this work, a variety of other capital projects are planned for 2012 – 2016. Examples include Information System and Sheriff's Record Management System improvements; Sheriff's Evidence Storage construction; the next phase of improvements to the Sheriff's Outdoor Range; replacement of the County Board electronic voting system; build out of space for a fifth circuit court branch in the Justice Center; remodeling projects at the Public Agency Center; Samaritan chiller replacement; and design and preparations for construction of an addition to the Jail. These planned projects have an estimated cost of more than \$17 million, spread over the next five years.

What costs would result if borrowing paid by tax levy is done to support our 2012-2016 capital program instead of funding it with sales taxes. This change in how to fund capital projects would have the following expected impact.

- Debt service in the annual budget will increase about \$365,000 per year starting in 2013
- Total cost of planned projects will increase about \$2 million due to added interest costs
- Total debt level paid by tax levy will increase about \$3 million per year from 2012–16

Cabela's Loan

When Washington County was working to attract Cabela's first southeast Wisconsin destination showroom, time and attention were devoted by County Supervisors and management to put together significant incentives to the company that would not require increased taxes from our taxpayers. The attraction plan and developers agreement negotiated included a \$4 million loan from the County, with a requirement that Cabela's pay for the annual principal and interest payments between 2009 and 2022. Cabela's is authorized to apply the annual county sales taxes collected from its Richfield store toward these payments, one year at a time. If the sales taxes collected are less than the amount of the payments due on the loan, Cabela's is required to pay the difference to the County. (Also of note, any excess sales tax collections in a year are applied to the next loan payment.) Since the county sales tax is the intended source of the largest portion of the loan payments, the loan is forgiven if the County repeals the sales tax. As of 2012, the balance on this loan is \$3,335,000. If repayment of this loan becomes the responsibility of the County because there is no longer a county sales tax, our additional cost would be \$4.5 million, including interest. The debt service cost in the annual budget would increase about \$400,000 per year and continue at that level through 2022. This is in addition to the financial impacts detailed when reviewing potential changes in how to fund the county capital program.

Economic Development Projects

In September 2010, the County Board authorized the use of sales taxes to fund approved private economic development projects. The first allocation for this purpose was in the 2011 capital plan and budget, a \$500,000 Impact Fund to be used for gap funding to complete a potential business

attraction project that was being actively pursued. In March, the Executive Committee heard a presentation by EDWC recommending that the County establish an Impact Revolving Loan Fund using sales taxes budgeted through the capital plan. An initial additional allocation of one million dollars for this new initiative in 2012 is a possibility, to be reviewed along with the rest of the capital improvement program requests. Such a program could be established using borrowed funds, but it would add to its cost (i.e. interest in addition to principal), and push the cost of debt repayment onto future property tax levies, rather than funding the program with current sales taxes. In an era when Washington County must compete harder to retain growing businesses that bring money into the local economy, the sales tax is a funding source to assist in the effort. Without a county sales tax, the County will probably have a more limited role.

Financial Condition

The sales tax contributes to a strong financial condition for Washington County in a number of ways. The half-cent tax has become widely accepted throughout the State, in place now in 62 of 72 counties. An estimated 14% of our collections come from non-residents. Property tax levies have been held below state levy limits, preserving some degree of local control and decision-making during difficult budget years. It provides for diversification of revenue streams, reducing the reliance on property tax levy. This benefits the County (e.g. smoothing of peaks and valleys closely related to a specific funding source, timing of payments, etc.), but also taxpayers (who feel more burdened by lump sum property tax bills than by “pay as you go” sales tax, and have less ability to trim the tax impact on their home taxes than they do on their spending). The allocation of sales taxes have been refined to accomplish the most financial benefit as applied to both debt avoidance and steady property tax offset. Integrating sales tax and capital planning has resulted in improved anticipation of financial needs, fewer big surprises, and better financial rating. All of these accomplishments would be harder to continue without the county sales tax as a steady revenue stream.

Recommendation

Both the experience with the half-cent sales tax and the expected impacts from ending it support its continuation. Washington County will be better with it than without it. For this reason, it is my recommendation that the County Board continue the sales tax in its current form. Considering how much we rely on this revenue stream, I see no reason to require another specific review date. If circumstances change and a future County Board wants to remove the sales tax, this can be considered along with a careful financial plan for how to transition to operating county government without it.

Doug Johnson
April 26, 2011