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LD 1: First Year of Progress 2005

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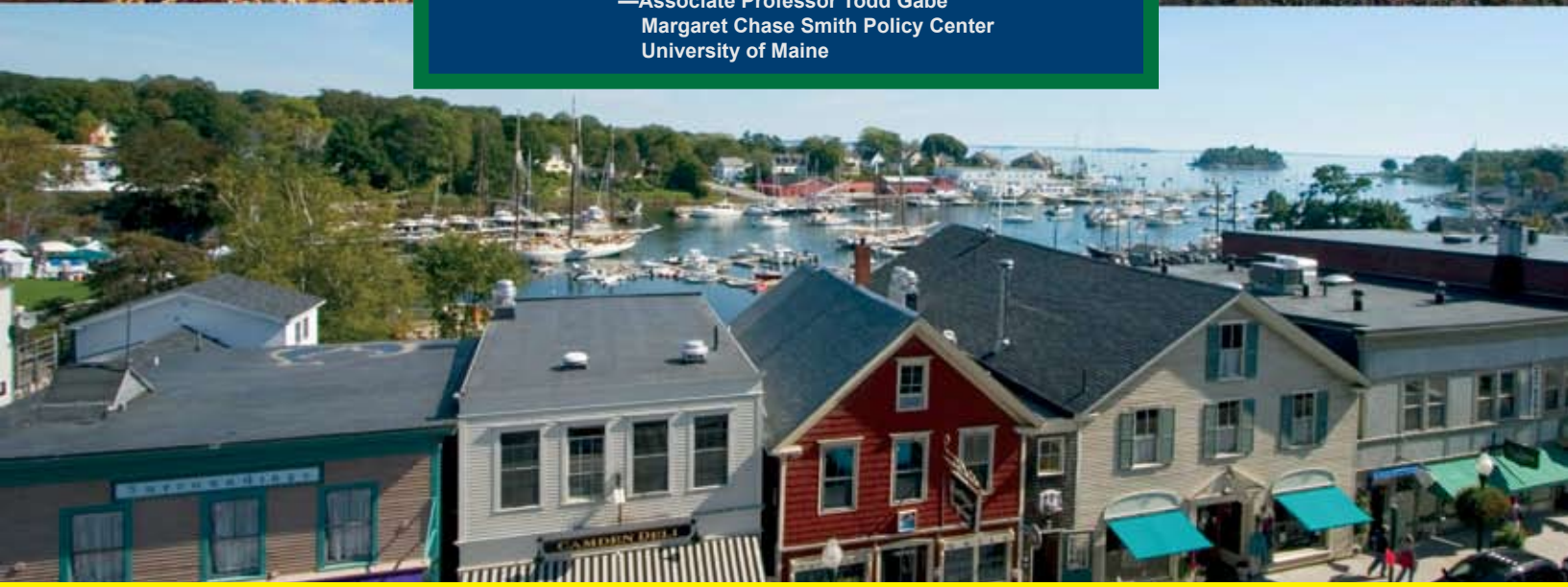
LD 1: First Year of Progress 2005

> "The early impact of LD 1 in reducing government spending is positive... Increased state subsidies provided for local education are contributing to the reduction in municipal government spending."
>
> —Associate Professor Todd Gabe
> Margaret Chase Smith Policy Center
> University of Maine



Meeting LD 1's Limits

State General Fund	☐ Over	☑ Under
Municipalities Combined Property Tax Levy	☐ Over	☑ Under
Counties Combined County Assessment	☐ Over	☑ Under
Schools Combined School Appropriations	☑ Over (3.4%)	☐ Under

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Introduction

In December 2004, Governor John E. Baldacci presented LD 1 to lower Maine's tax burden and, in particular, the property tax burden of Maine residents. The Legislature's Joint Select Committee on Property Tax Reform considered LD 1 for countless hours. In January 2005, the Legislature passed LD 1 by wide margins in both houses. LD 1 is now law (Public Law 2005, Chapter 2).

The values of Maine people form the context for LD 1. We are concerned about tax burdens and we care about the services and investments that state and local governments make on our behalf. Consequently, LD 1 limits growth of spending at all government levels and establishes a goal to lower Maine's tax burden. It also steps up targeted property tax relief programs for Maine residents and increases the State's share of education funding. Brief explanations of keys to LD 1 appear on the back of this report.

LD 1 requires the Maine State Planning Office to analyze government spending by the State, school administrative units, municipalities, and counties, establish performance indicators, and report on progress toward the tax burden reduction goal. The State Planning Office contracted with the Margaret Chase Smith Policy Center at the University of Maine and Associate Professor Todd Gabe for an analysis of data reflecting the early impacts of LD 1. The full text of Professor Gabe's report is available at www.maine.gov/spo, as is the state, school, municipality, and county data that he analyzed.

The bottom line? While we have yet to see the full effects of LD 1, Professor Gabe's work, excerpted in this report, shows that in these early days LD 1 is having its overall intended effect.

We thank the Margaret Chase Smith Policy Center and Maine Revenue Services for their work. The Maine Municipal Association, Kennebec County Commissioners' Office, Maine Department of Administrative and Financial Services, Maine Department of Education, Maine Department of Audit, City of Augusta, and many other local and county officials provided much-appreciated data and technical guidance.

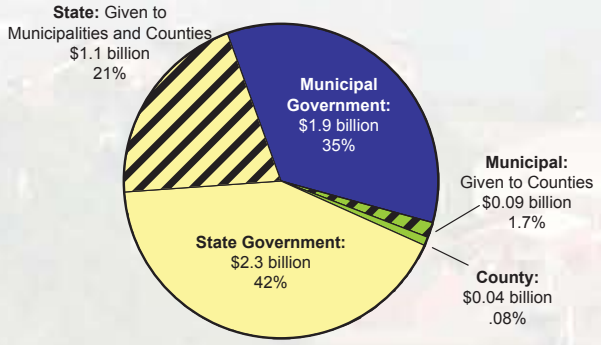
Martha Freeman
Director, State Planning Office

Catherine Reilly
State Economist

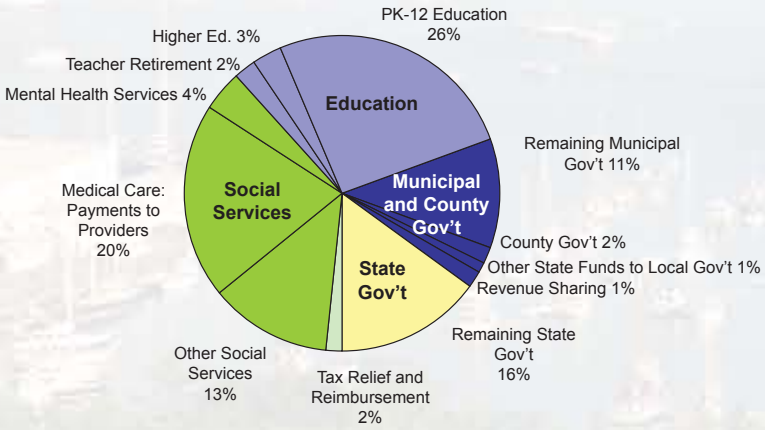
The Cost of Public Services in Maine

The starting place of any analysis of LD 1 is, "Where are government revenues raised and on what do we spend them?" The charts below provide that picture. The majority of tax revenues are raised at the state level, but much of that is redistributed to local governments. Education and social services are the largest budget items for government, accounting for about two-thirds of spending.

Estimated Revenue Raised by Maine Governments 2004



Estimated Expenditures by Maine Government 2004

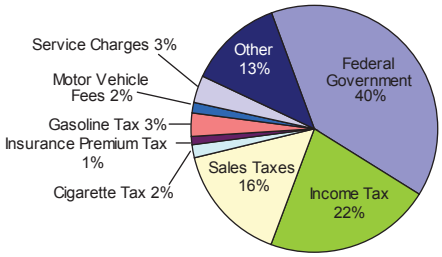


Sources: Maine Revenue Services, Maine State Legislature Office of Fiscal and Program Review, Maine Municipal Association, Kennebec County Commissioners' Office. To obtain estimates of 2004 county and municipal expenditures other than education, and revenues other than taxes, appropriate growth rates were applied to 2003 data.

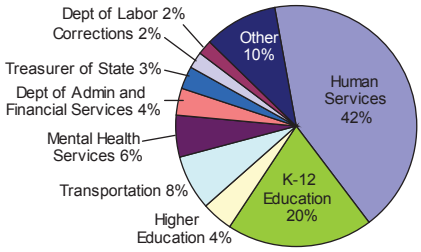
State

"The State receives about 40% of its funding from the federal government, 22% from income taxes, and 16% from sales tax. The remaining revenue comes from other taxes and fees. Human services and K-12 education are the largest budgetary expenses for the State, accounting for about 2/3 of spending" (Gabe, 2006).

State Operating Revenue 2004 $5.9 billion



State Operating Expenditures 2004 $5.8 Billion



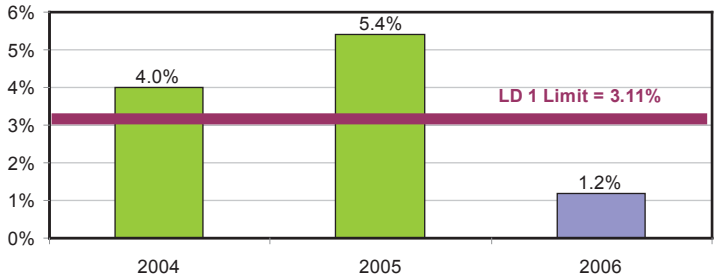
Source: Maine State Legislature, Office of Fiscal and Program Review

LD 1 Limit on Spending

LD 1 limits growth of the State's General Fund appropriations to the growth rate of Maine's average personal income (adjusted for inflation) plus Maine's average population growth. When the current budget was signed in early 2005, income growth was 2.58% and population growth was 0.53%. Therefore the growth limit was 3.11%. Increased education spending is outside that limit.

"The State has stayed within its biennial budget growth limit of 3.11%. Growth of General Fund appropriations is lower this year than the past two years, 1.2% versus 4.0% and 5.4% respectively" (Gabe, 2006). The State has met its obligation to increase education funding to 46.5% for the 2005-06 school year and doubled its spending on the Circuit Breaker property tax relief program for Maine residents.

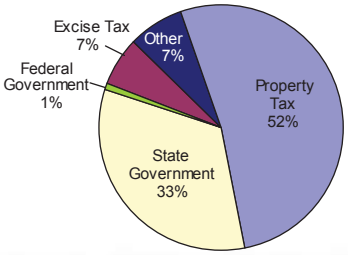
State General Fund Appropriation Growth



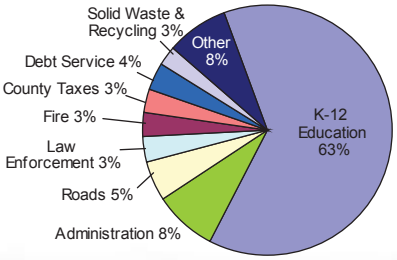
Municipalities

"Municipalities raise about 2/3 of their revenue locally through property taxes, excise taxes, and fees. Property taxes account for about 80% of that revenue. The remaining 1/3 of municipal revenue comes from the State. K-12 education is by far the largest budget item for municipalities, accounting for about 2/3 of spending" (Gabe, 2006).

Municipal Revenue 2003 $2.92 billion



Municipal Expenses 2003 $2.97 billion



Source: Estimates generated by Maine Municipal Association, 2004 Fiscal Survey Report & Analysis. FY03 is the most current year for which a breakdown is available.

LD 1 Limit on Property Tax Levies

LD 1 limits growth of each municipality's property tax levy to the growth rate of Maine's average personal income (adjusted for inflation) plus the municipality's property growth factor. The property growth factor is different for each town; it is a measure of the new development occurring within the municipality's borders. LD 1 permits a municipality to spend over the cap, if the municipality's legislative body votes to do so. K-12 education funding and county assessments are outside that limit.

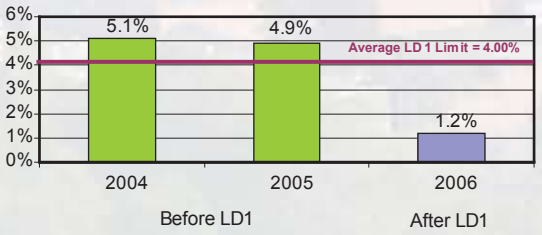
"The property tax limits of LD 1 applied to about 214 municipalities this year. Of municipalities for which data is available, about 60% stayed within their limit" (Gabe, 2006).

When considered as a group, these municipalities were below their collective limit. Looking at reported property tax levy limits in all municipalities to which LD 1 applied, Professor Gabe calculated an average limit of 4%. Total property taxes levied by those towns rose 1.2%. This is lower than growth in the past two years, 5.1% and 4.9% respectively.

Property taxes statewide decreased even when considering municipalities to which LD 1 has not yet applied. "Across all municipalities, the growth rate of local property tax commitments is lower this year than in the past two years, 1.7% versus 5.1% and 5.5% respectively. The reduction of growth is greater in municipalities to which LD 1 applies" (Gabe, 2006).

Property Tax Growth

(Towns to which LD1 Applied)



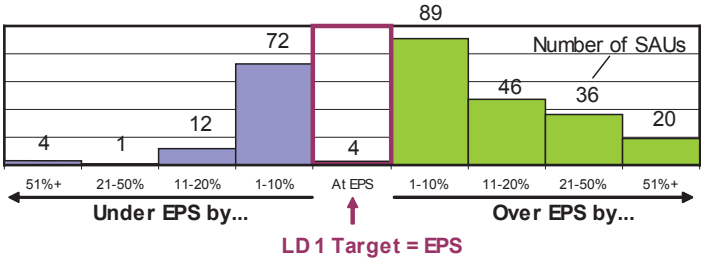
School Administrative Units

"In 2004, schools received over half of their funding from municipalities through property taxes and the rest from the State and other sources. Student instruction is the largest budget item for schools, accounting for over 2/3 of spending" (Gabe, 2006).

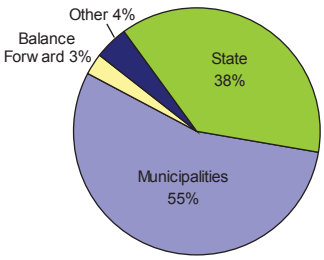
LD 1 and School Spending

Funding for schools is calculated on a per-pupil basis through the Essential Programs and Services (EPS) school funding formula. The state target is for schools to be at 100% of EPS. Communities may spend more than 100% of EPS if their legislative body votes to raise the extra money locally. This year, about two-thirds (69%) of school administrative units (SAUs) spent more than 100% of EPS. The chart below shows the degree to which SAUs were over or under EPS. The combined budgets of all SAUs were 3.4% above the spending needs calculated by EPS.

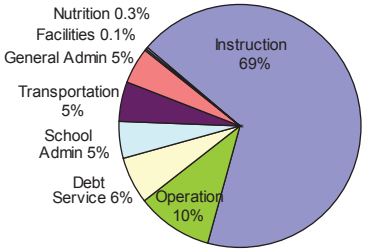
SAU Spending Relative to EPS



School Revenues 2004 $1.8 Billion



School Budget Expenditures 2004 $1.8 Billion



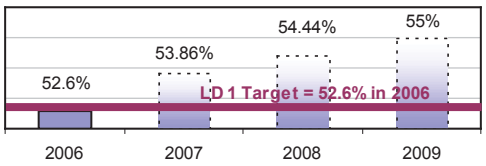
Source: Maine Department of Education

LD 1 and Property Tax Relief

In a sample of 139 towns and cities, increased state funding corresponded to lower growth in municipal tax commitments. "In single-municipality SAUs, spending projections based on past commitments exceed actual current spending by $34.0 million. The lower amount of actual spending corresponds closely to increased state subsidies for education received by those municipalities ($35.5 million)" (Gabe, 2006).

In total, the State increased education spending by $99 million this year, to 52.6% of covered EPS costs. The State will add at least another $37 million next year. These increases will continue until the state share is 55% of total EPS costs in 2009.

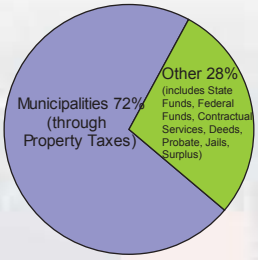
State Share of EPS



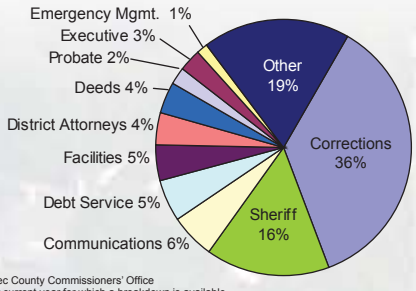
Counties

"Counties receive about 3/4 of their funding from municipalities. Jails and law enforcement are the largest budget items for counties, accounting for over 50% of spending" (Gabe, 2006).

County Revenues 2003 $0.13 billion



County Expenditures 2003 $0.13 billion



Source: Kennebec County Commissioners' Office
FY03 is the most current year for which a breakdown is available.

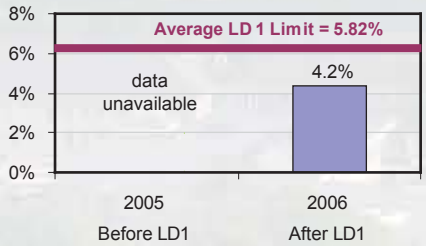
LD 1 Limit on County Assessment

LD 1 limits growth of each county's assessment (an amount charged to municipalities within the county and paid for through property taxes) to the growth rate of Maine's average personal income (adjusted for inflation) plus the county's property growth factor. The property growth factor is different for each county; it is a measure of the new development occurring in the municipalities within each county. LD 1 permits a county to spend over the cap, if the county's legislative body votes to do so.

The assessment limit of LD 1 applied to all counties. However, since 15 of Maine's 16 counties begin their fiscal years on January 1, final budget information was not available at the time of publication. Of the 13 counties for which preliminary information was available, 11 (85%) expected to be at or below their assessment limit for 2006.

When considered as a group, the 13 counties were below their collective limit. Looking at reported county assessment limits, SPO calculated an average limit of 5.82%. On average, assessments by those counties rose 4.2%. Data to compare this to previous years' growth is unavailable. In future years, current growth rates will serve as a basis for comparison.

County Assessment Growth



Maine's Progress toward Tax Burden Reduction

LD 1 sets the goal of lowering Maine's overall tax burden. It establishes US Census Bureau rankings of state and local tax burden, as adjusted by the State Tax Assessor, as the measure of progress toward that goal. Census rankings lag several years. Therefore it will be a while before we have actual data that compares Maine's current tax burden to other states.

We can, however, begin to judge Maine's progress based on a number of performance indicators. The State Planning Office established three additional performance indicators for LD 1:

1) adherence to growth limits at all levels of government;

2) progress toward overall tax burden reduction;

3) achievement of property tax burden reduction for Maine residents.

Professor Gabe reports on the first two. Maine Revenue Services will perform an analysis in early 2006 that addresses the third.

Professor Gabe sought to glean what he could about tax burden reduction progress from data available during preparation of the report. LD 1 has been law for less than a year. Municipalities and counties operate under differing fiscal year cycles, so LD 1 did not apply to all of them in 2005. Furthermore, increased state funding for education will ramp up over the next three years.

In this first year, progress can best be measured by the impact of LD 1 on spending and revenue at each level of government. As the bullets below explain, overall growth in the areas targeted by LD 1 has slowed since the law's enactment. "We find that LD 1, in its early impact, has constrained the growth of state and local governments in Maine" (Gabe, 2006).

In his report, Professor Gabe also provides context for future analysis: "Compared to other states, governments in Maine are above the national average in reliance on taxes as a source of general revenue and below the national average in reliance on other sources, such as fees" (Gabe, 2006).

Summary Findings

- The State, about 60% of municipalities, and about 85% of counties have adhered to the growth limits set by LD 1. 31% of school administrative units are spending at or below 100% of EPS.
- Growth of the State's General Fund appropriations slowed by 78% from FY2005 to FY2006.
- Statewide, the growth of property taxes in towns to which LD 1 applied slowed by 77%.
- Statewide, county assessments are 28% below the LD 1 limit.

Keys to LD 1

What is the Homestead Exemption?

The Homestead Exemption is a law that makes property taxes more affordable for Maine residents. It allows them not to pay taxes on part of their home's value. That part becomes "exempt." When the Homestead Exemption was created in 1998, the exempt amount was $7,000. LD 1 increased it to $13,000. About 310,000 Maine homeowners apply this exemption each year.

What is the Circuit Breaker Program?

The Circuit Breaker, or Maine Residents Property Tax Program, assists Maine resident homeowners and renters whose property tax bills or property tax-related rent are high compared to their incomes. LD 1 increased the maximum amount that can be received through this program from $1,000 to $2,000. LD 1 also increased the number of homeowners and renters expected to benefit from the program to about 95,000. These changes increased the amount of state funding given to Maine resident property taxpayers and renters by $17.5 million this year alone.

What is a Revaluation?

The Maine Constitution requires municipalities to assess all properties fairly, equally, and according to market value. LD 1 did not change this law. During a revaluation, an assessor employed by the municipality estimates the current value of all homes and businesses so that everyone will be taxed equitably. The assessor estimates a property's value by looking at the prices of similar property recently bought in the area.

After a revaluation, municipal property tax rates are applied to the newly-assessed property values. Based on property values, some tax bills will increase, others will decrease, and some will stay the same. Over time, some home values rise quickly while others rise slowly. For example, the price of some waterfront homes has increased quickly in recent years, while the price of inland homes has grown more slowly. Regular revaluations are required by law to make sure that property is being taxed based on its value in the marketplace, so that values are fair.

What is the Budget Stabilization Fund?

LD 1 established the Maine Budget Stabilization Fund to provide a savings account or "rainy day" fund for the State to protect taxpayers against wide swings in state tax levies. Amounts in the fund are to be expended only to offset a state General Fund shortfall (rather than raising taxes). Amounts in the fund are not to fall below 1% nor exceed 12% of General Fund revenue. If the fund is at its 12% limit, excess amounts are transferred to the legislatively-created Tax Relief Fund for Maine residents.

What is the Essential Programs and Services School Funding Formula?

The passage of LD 1 marked the beginning of a new era in the way Maine funds its public school system. LD 1 increased the amount of K-12 education costs paid for by the State and changed the way state education funds are distributed to local schools. The goal is for all Maine students, no matter where they live, to have access to the same level of educational resources, and to reduce the amount of property taxes needed to pay for education.

The Essential Programs and Services (EPS) school funding formula identifies the types and amounts of resources needed in all Maine schools, calculates their cost, and provides the needed per pupil funding for each school unit. Key resources included in the formula are: school personnel, administration, building maintenance, and specialized student services. Then there are adjustments for transportation, vocational education, debt, and isolated schools.

The cost of K-12 education in Maine is shared by state and local governments. Today the State pays about 46.5% of the total statewide costs of education. LD 1 increases the state share each year up to 55% by FY 2009. For the 2005-06 school year, the amount of state money given to local communities for K-12 education increased by $99 million.

The Essential Programs and Services formula does not tell local communities how they must spend their education funds. Communities may decide to raise additional funds locally over the funding formula amounts, rather than use the increased state funding for property tax reduction.