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RIPEC
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Update to the State's Property Tax Cap Legislation

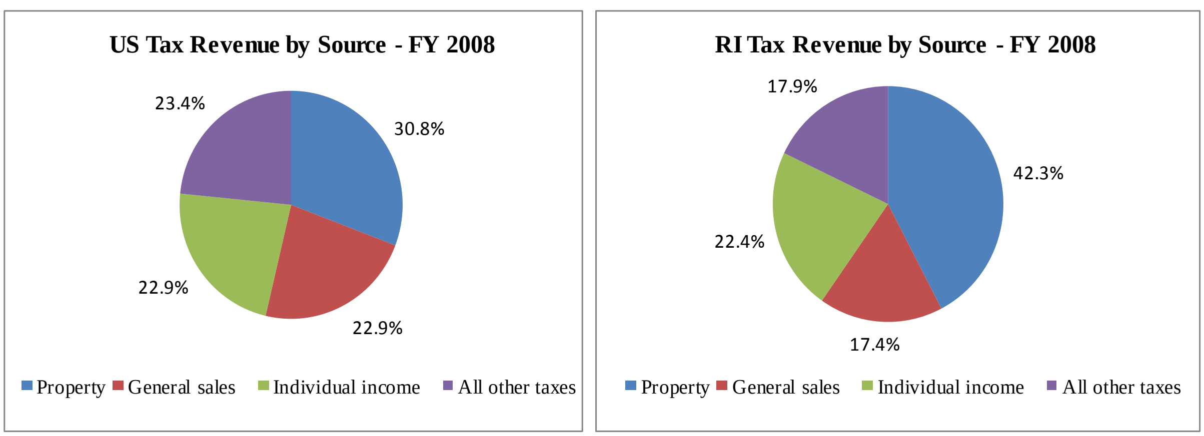
This RIPEC Comments examines the effectiveness of the state's property tax cap legislation, popularly known as S-3050. The legislation closed a loophole in Rhode Island law whereby the cap applied to either growth in the levy or the rate: S-3050 requires the cap to be applied to the entire levy and decreases the rate of growth each year in an effort to control the rate of growth in Rhode Island's property tax burden. In addition to providing an overview of the legislation and an update on its implementation and effectiveness, this "Comments" examines a number of bills before the General Assembly that would alter S-3050.

Introduction

Rhode Island's property tax burden has consistently been one of the highest in the country. In FY 2008, the most recent year for which comparable data is available, the state's property tax burden of $48.35 per $1,000 of personal income ranked 5th highest in the country and was 40.5 percent higher than the national average. On a per capita basis, the state's property tax collections of $1,951 were the 6th highest in the country, and 43.6 percent higher than the national average. Moreover, the state relies more on property taxes to fund government services than the rest of the country. Property taxes accounted for almost 42 cents of every dollar raised by Rhode Island's state and local governments in FY 2008. In contrast, property taxes accounted for 31 cents of every dollar raised by state and local governments nationally.

There is general consensus that revenue systems should be built on a "three-legged stool" approach to taxation. That is, personal income, sales, and property taxes should form the basis of revenue generation, and should be supplemented by excise taxes, business taxes, severance taxes, and user charges. In addition to generating the majority of government

Chart 1
Rhode Island and US Tax Revenue by Source - FY 2008



Source: US Census Bureau, Government Finance, FY 2008 data, RIPEC calculations revenue, however, the three primary sources of taxation should be roughly balanced. That is, states should not rely too much on one form of taxation for revenue generation. Despite this public finance tenet, local circumstances, social and economic considerations, and political predilections determine how closely this guideline is followed. For example, New Hampshire relies almost exclusively on local property taxes to fund public services while Alaska relies heavily on extraction taxes.

While a state's particular set of circumstances may dictate their particular blend of taxes, Rhode Island's continued reliance on the property tax is a significant contributor to the state's persistently high ranking when it comes to overall tax burdens[1]. Further, the state's high property taxes are frequently cited as a negative factor with regard to business climate rankings. A March 2010 report by the Council on State Taxation (COST) and Ernst & Young indicated that property taxes collected in Rhode Island accounted for over half of the taxes paid by businesses in FY 2009, compared to 36.5 percent nationally. The Tax Foundation, which ranked Rhode Island's business climate 42nd in their most recent report, ranked the state's property tax climate 47th, the worst ranking the state received in the report with the exception of the unemployment insurance tax ranking.

The property tax cap legislation popularly known as S-3050, which was enacted in 2006, represented a step toward reforming the state's burdensome property tax system. The legislation was intended to close a loophole that previously existed in state law in which the prior cap was applied to either the rate or the levy, and to slow the rate of growth in the property tax. As the state, municipalities and Rhode Islanders recover from the recent economic downturn, the intent of this legislation should be maintained. This report provides an outline of S-3050, its effectiveness, and current challenges to the legislation.

[1] It should be noted that property tax rates vary by community and class of property. It is thus difficult to generalize the overall property tax burden from community to community.

Overview of S-3050

In 2006, the General Assembly enacted S-3050. The legislation limited the growth in the property tax levy to 5.25 percent over the prior year's levy. The rate of growth was decreased by 0.25 percent annually until reaching a maximum growth rate of 4.0 percent in FY 2013. As noted earlier, prior to passage of the legislation, the property tax cap could be applied either to the rate or to the levy.

Table 1
S-3050 Cap

Fiscal Year	Proposed Cap	Applies Cap to
2007	5.50%	Levy or Rate
2008	5.25%	Levy
2009	5.00%	Levy
2010	4.75%	Levy
2011	4.50%	Levy
2012	4.25%	Levy
2013+	4.00%	Levy

Source: S-3050 Sub A

Communities may qualify for an exemption to the cap if they meet a specified set of criteria:

- A loss of non-property tax revenues (e.g., a reduction of state or federal aid);
- In the event that growth in debt service exceeds the maximum allowable levy growth; or
- If the municipality experiences significant growth in its property tax base.

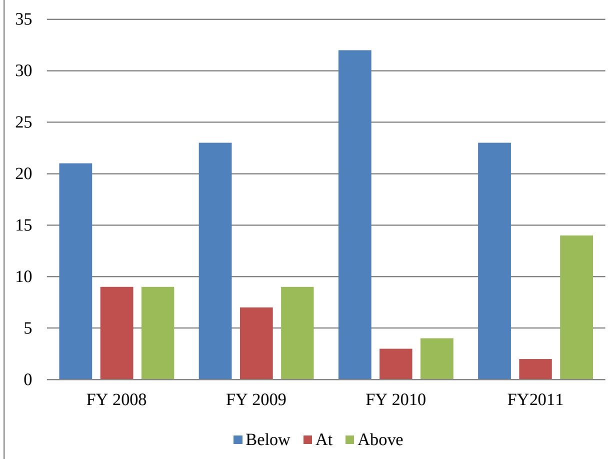
In all three cases, the exemption must be approved by a supermajority of the town council and by the Division of Municipal Finance. In addition, an exemption may be granted in the event of an emergency, that is, in the event that health care, retirement contributions or utility costs increase at a rate three times the cap. This exemption must be certified by the Auditor General.

The legislation allows for communities to adopt the prior year's budget if the next fiscal year's budget is not adopted on time. In addition, S-3050 includes language designed to minimize the use of administrative rulemaking to pass on unfunded mandates to localities and language that attempts to limit the scope of court decisions related to education funding.

Effectiveness of S-3050

As shown on chart 2, between FY 1986 and FY 2011, statewide property taxes in Rhode Island increased by $1.5 billion, or at an average annual rate of 5.2 percent. The first ten years of this time period saw an average annual rate of growth of over 7 percent annually. Growth in the total statewide levy slowed in the second half of the time period, ranging from an annual increase of 2.4 percent in FY 2001 to a high of 6.7 percent in FY 2004. Prior to the passage of S-3050, from FY 2003 to FY 2007, the statewide levy grew at an average annual rate of 4.8 percent. Since S-3050 has been in effect, from FY 2007 to FY 2011, the statewide levy has increased at an average annual rate of 4.5 percent.

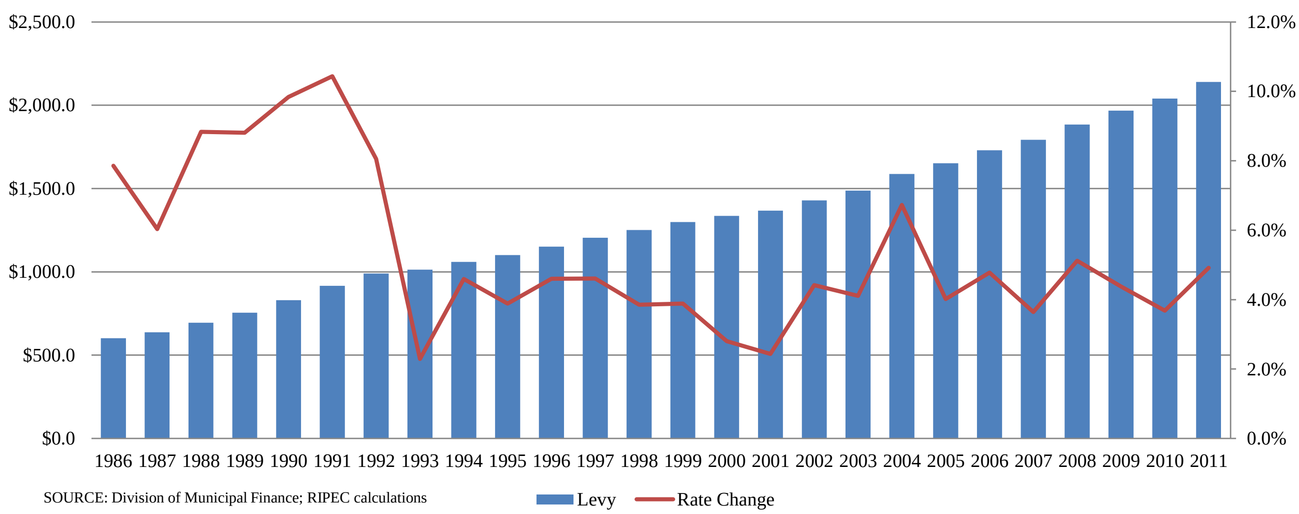
Chart 3
Rhode Island Communities Below, At, and Above Levy Cap



SOURCE: Division of Municipal Finance; RIPEC calculations

Another way to determine the effectiveness of the levy cap is to examine the number of communities that have applied for an exemption to the cap, as shown on chart 3. Since FY 2008, the first year the cap was applied to the levy, the majority of communities in Rhode Island saw property tax growth below the cap. In FY 2010, 32 communities experienced levy growth below the cap of 4.75 percent. In FY 2011, however, 14 communities were granted an exemption (16 requested an exemption; Warren did not request an exemption, but exceeded the cap). Since the passage of the legislation, two communities, Tiverton and West Greenwich, have exceeded the cap three times. Nine others

Chart 2
Statewide Property Tax Levy and Rate Change, FY 1986 - FY 2011 ($ millions)



SOURCE: Division of Municipal Finance; RIPEC calculations

(Cumberland, East Greenwich, East Providence, Glocester, North Providence, North Smithfield, Pawtucket, Richmond, and Westerly) exceeded the cap in two of the four years. During the same time period, 13 communities exceeded the cap once and 15 did not exceed the cap in any year between FY 2008 and FY 2011. Of note, although the statewide levy growth between FY 2006 and FY 2007 was just 3.6 percent, seventeen communities had growth rates that exceeded the FY 2008 levy growth cap of 5.25 percent.

Table 2
Growth in Levy by Community, FY 2008-FY 2011

	FY 2007	FY 2008	% Growth	FY 2009	% Growth	FY 2010	% Growth	FY 2011	% Growth
Barrington	$45,054,422	47,347,311	5.09%	49,602,859	4.76%	$51,856,526	4.54%	$53,898,607	3.94%
Bristol	30,715,501	31,466,379	2.44%	33,426,741	6.23%	33,449,298	0.07%	34,320,310	2.60%
Burrillville	19,481,713	20,379,384	4.61%	21,011,173	3.10%	21,867,633	4.08%	23,547,101	7.68%
Central Falls	9,968,176	10,075,041	1.07%	10,495,379	4.17%	10,570,404	0.71%	12,612,856	19.32%
Charlestown	17,752,958	18,780,800	5.79%	19,708,925	4.94%	20,395,658	3.48%	21,015,696	3.04%
Coventry	53,614,508	56,292,004	4.99%	59,106,603	5.00%	59,014,126	-0.16%	59,562,835	0.93%
Cranston	144,155,099	151,718,441	5.25%	153,150,874	0.94%	160,419,261	4.75%	175,003,222	9.09%
Cumberland (1)	46,603,494	50,571,523	8.51%	52,454,310	3.72%	52,119,987	-0.64%	56,732,858	8.85%
East Greenwich	35,309,164	37,726,180	6.85%	39,575,719	4.90%	41,524,344	4.92%	43,145,369	3.90%
East Providence (2)	75,642,921	82,082,303	8.51%	84,725,950	3.22%	87,805,607	3.63%	95,449,200	8.71%
Exeter	10,573,166	11,108,972	5.07%	11,672,749	5.07%	11,763,351	0.78%	12,280,009	4.39%
Foster	8,225,871	8,657,612	5.25%	9,879,531	14.11%	10,345,673	4.72%	10,766,802	4.07%
Glocester	16,578,703	18,134,554	9.38%	19,541,335	7.76%	20,380,911	4.30%	20,960,378	2.84%
Hopkinton	14,574,762	15,091,660	3.55%	15,651,281	3.71%	15,794,049	0.91%	17,550,424	11.12%
Jamestown	16,021,392	16,727,176	4.41%	17,562,744	5.00%	17,734,650	0.98%	18,335,933	3.39%
Johnston	54,944,037	61,086,592	11.18%	61,791,239	1.15%	63,658,365	3.02%	66,483,714	4.44%
Lincoln	45,176,212	47,459,085	5.05%	49,267,068	3.81%	50,599,475	2.70%	52,359,144	3.48%
Little Compton	8,534,196	8,981,920	5.25%	9,425,477	4.94%	9,441,514	0.17%	9,850,654	4.33%
Middletown	35,038,059	36,797,355	5.02%	38,487,041	4.59%	39,247,059	1.97%	40,149,738	2.30%
Narragansett	37,131,463	38,325,157	3.21%	40,209,538	4.92%	42,106,773	4.72%	43,979,133	4.45%
Newport	54,975,217	56,490,825	2.76%	58,945,707	4.35%	60,914,809	3.34%	60,913,756	0.00%
New Shoreham	6,296,702	6,614,259	5.04%	6,932,888	4.82%	7,529,857	8.61%	7,867,482	4.48%
North Kingstown	56,991,563	59,586,154	4.55%	62,565,154	5.00%	63,293,577	1.16%	65,766,677	3.91%
North Providence	50,883,621	51,581,994	1.37%	53,303,326	3.34%	60,468,663	13.44%	65,311,452	8.01%
North Smithfield	20,304,558	21,370,406	5.25%	24,190,127	13.19%	25,090,079	3.72%	27,034,593	7.75%
Pawtucket	75,606,746	78,892,841	4.35%	81,691,527	3.55%	88,299,368	8.09%	92,445,040	4.70%
Portsmouth	36,525,097	38,442,372	5.25%	40,361,114	4.99%	42,275,881	4.74%	44,174,990	4.49%
Providence	261,450,407	275,329,161	5.31%	287,211,711	4.32%	294,186,862	2.43%	307,014,942	4.36%
Richmond	12,190,366	12,822,091	5.18%	13,852,385	8.04%	14,376,803	3.79%	15,073,977	4.85%
Scituate (3)	21,228,576	22,342,551	5.25%	23,459,585	5.00%	24,570,658	4.74%	24,841,929	1.10%
Smithfield	39,873,408	41,966,249	5.25%	44,064,149	5.00%	46,156,583	4.75%	48,233,107	4.50%
South Kingstown	57,665,645	60,692,561	5.25%	63,726,992	5.00%	64,504,174	1.22%	65,499,433	1.54%
Tiverton	25,528,274	28,131,165	10.20%	31,230,364	11.02%	32,187,296	3.06%	34,703,682	7.82%
Warren*	18,000,102	18,580,185	3.22%	19,508,191	4.99%	19,874,748	1.88%	21,157,489	6.45%
Warwick	178,109,804	187,228,328	5.12%	195,989,706	4.68%	204,173,334	4.18%	208,897,991	2.31%
Westerly	53,295,690	56,058,965	5.18%	58,931,924	5.12%	59,205,119	0.46%	62,933,570	6.30%
West Greenwich	12,919,189	14,048,611	8.74%	16,092,264	14.55%	16,850,480	4.71%	17,608,912	4.50%
West Warwick	44,699,149	47,044,147	5.25%	49,395,487	5.00%	51,700,991	4.67%	51,841,899	0.27%
Woonsocket	41,490,234	40,868,441	-1.50%	42,128,184	3.08%	44,130,573	4.75%	50,867,593	15.27%
Total	$ 1,793,130,162	$ 1,886,900,755	5.23%	$ 1,970,327,321	4.42%	$2,039,884,519	3.53%	$2,140,192,494	4.92%
Cap			5.25%		5.00%		4.75%		4.50%

* Did not request an exemption in FY 2011 and was not certified to exceed the cap.

(1) Cumberland actual is an estimate supplied by the town; final levy was set May 2011

(2) East Providence fiscal year is Nov 1 to Oct 31; the town levies its property taxes in arrears, final rates were not set as of Division of Municipal Finance report publication date

(3) Scituate's fiscal year is April 1 to March 31

SOURCE: Dicision of Municipal Finance "Report on the Property Tax Cap" various years; RIPEC calculations

Table 2 shows property tax levies by community between FY 2007, the first year to which the levy growth cap was applied, and FY 2011. Prior to the current fiscal year, statewide levy growth has been below the levy cap. Growth in the statewide levy in FY 2011, however, was 4.92 percent over the prior fiscal year, exceeding the current growth cap of 4.5 percent by almost half a percentage point. According to the Division of Municipal Finance, the majority of exemptions granted in the current fiscal year were related to the loss of non-property tax revenue (93.6 percent), while the remainder was related to debt service.

Proposed Changes to S-3050

As in past legislative cycles, there have been a number of efforts to modify the requirements under S-3050. This section summarizes the relevant legislation that has been introduced this legislative session.

S-0559

Introduced by Sen. P Fogarty on March 10, 2011, S-0559 makes four changes to S-3050. The bill:

- Allows for revenue received by a municipality in FY 2011 and thereafter that is the result of new growth to be added to the maximum levy;
- Exempts debt service expenditures that have been approved by voters from the cap;
- Requires that school department appropriations not exceed their share of the maximum levy growth; and
- Allows communities to request an exemption if federal or state aid is reduced by more than 10.0 percent in relation to other communities or districts.

It does not appear that the bill specifies whether the term "new growth" relates to new construction, that is, additions to the tax base, or to natural growth occurring as a result of property values stabilizing and revaluations. It should also be noted that the modification to allowable exemptions may allow some communities who are projected to lose state aid as a result of the recently-enacted funding formula to qualify for an exemption. When taken as a whole, this bill would allow for potentially substantial increases in the levy, above and beyond the limits established under S-3050 with only this local budget authority's approval, circumventing one of the primary intentions of the original legislation.

H-5496

Introduced by Rep. E Coderre and J O'Grady, on March 2, 2011, H-5496 allows for municipally-designated "growth centers". Revenues in excess of those collected in FY 2010 are excluded from the levy cap, up to a maximum of 2.0 percent, provided the revenues are used to fund capital development projects in the designated growth centers. The growth centers must be designated as such in a plan submitted by the community to the state's Division of Planning, and in accordance with the terms and conditions set forth in "Handbook 16".[2]

This legislation appears to be a variation on tax incremental financing (TIF) and achieves these goals by exempting a portion of the levy from the cap. These revenues would then be used to finance specified capital projects within designated areas. There are concerns with regard to oversight and transparency, given that the bill would allow municipal leaders wide latitude with regard to the projects funded by the additional revenues, e.g., the term public amenity. It appears that a large number of the objectives of the bill could be achieved by the creation of a business improvement district (BID). Given the current definitions of district

[2] In effect, areas which incorporate concepts of compact, mixed-use development, preservation of open space, conservation of natural resources, and that fit "development to the capability of the land to support development and the availability of infrastructure".

management authorities (RIGL 45-59), a BID may allow for greater oversight and input than the proposed legislation.

H-5838

House bill 5838 was introduced by Rep. S Azzinaro, March 8, 2011. The bill modifies S-3050 by establishing a maximum tax rate increase, rather than a maximum levy increase. The bill maintains the percent schedule from S-3050, but applies the growth to the tax rate. Moving the growth limitation to the rate side of the equation, rather than the levy side, may have the unintended consequence of hurting communities that are most fiscally distressed. These communities are the most likely to have seen a decrease in value over the past few years and any revaluation that results in a smaller assessment than the year prior could result in a decrease in levy growth for communities. Conversely, communities that see significant increases in their property value as a result of new construction or as the result of a revaluation could potentially see significant growth in their property tax burdens. By only allowing communities to affect their rate, this bill restricts the ability of a community to set its levy.

H-6139 and S-1047

House bill 6139, introduced by Rep. B Newberry on May 12, 2011, and its companion bill S-1047, introduced by Sen. J Tassoni, M Cote, and P Fogarty affect North Smithfield only. The bills allow for tax revenues related to the "Dowling Village development" to be exempted from the property tax cap. Property tax revenues generated from the development would be used to repay the bond issuance for construction of a new middle school in the community – effectively a form of TIF. While the intent of the bill is to offset the impact caused by a delay in completion of the development, which was intended to be completed before the cap went into place, this legislation may set a precedent for other communities. The prolonged recession has delayed the completion of a number of projects around the state; this legislation would potentially allow any community with delayed construction to request revenues from those projects to be exempted as well.

RIPEC Comments

The property tax cap appears to have had some success with regard to controlling lowering the rate of growth in the property tax across the state. Even during a time when state aid to municipalities has been reduced, the majority of municipalities have increased their levy at a rate at or below that of the allowable cap. In FY 2011, when most communities qualified for an exemption as a result of a decrease in non-property tax revenues due to cuts in state aid, less than half of the communities in the state actually enacted levies that were over the cap. In addition to helping control the rate of growth in property taxes, S-3050 allows local governments to respond to changes in their fiscal situation that are outside their control, such as the loss of state aid.

Changes to S-3050 should be undertaken with caution. The current legislation, as noted, provides municipalities with significant controls to adjust their levy in the face of serious fiscal challenges. Altering the basic controls outlined in the legislation – particularly when there may be alternative methods of addressing the issue – undermines the intent of the legislation. Furthermore, it opens the door to increased modifications that have the potential to undo the progress the state has made with regard to controlling the rate of growth in the property tax. While RIPEC recognizes that the state and its municipalities are facing very real fiscal challenges, we do not feel that this is the correct time to modify one of the most significant pieces of tax legislation to come out of the General Assembly in the past decade.