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Fiscal Impact Analysis: Unrealistic Assumptions

TischlerBise conducted a Fiscal Impact Analysis (FIA) for Anne Arundel (AA) County using a standard methodological approach that it has employed in performing similar analyses for many other clients. Unfortunately, the unrealistic assumptions employed in projecting growth over an 18 year time period raise serious concerns about the validity of their findings that new growth pays for itself and that faster growth of both residential and nonresidential development generate better fiscal results than trends development.

The FIA performs little sensitivity analyses evaluating the implications of their assumptions and the consequences of these findings not being correct. However, the combined potential impact of BRAC on residential development; the property tax cap and more realistic assumptions about inflation, service needs, future revenue streams and debt service charges can drastically alter the findings presented in the FIA. Many studies find that residential development does not pay for itself, so the mix between residential, commercial and industrial and agricultural/open land use matters significantly as well.

Extensive effort is required before the underlying model discussed in this report can serve as a meaningful tool for the County to use for concurrency management. The implications of the TischlerBise findings being reversed if more realistic assumptions are used, coupled with the existing large and growing backlog of unmet service needs, would further exacerbate the financial problems faced by AA County. Moreover, the failure of ALL of our waterways to meet minimal water quality standards will require significant additional expenditures by the county which are not considered in the FIA. It does not consider environmental costs at all.

1. Zero Inflation

A zero inflation assumption is only valid if the costs associated with new development are covered by the revenues generated by new development. However, numerous studies have shown that in a tax cap county, this is not a realistic expectation. As an example, The Center on Budget and Policy Priorities, *The Problems with Property Tax Revenue Caps*, by Lav and Lyons states:

“While such caps may hold down property taxes, they are likely to impair local governments’ ability to provide education, public safety and other services residents demand and need. Property tax caps do nothing to change the main drivers behind higher property taxes. They cannot slow the increase in the cost of health care or fuel, for example, which reflects forces outside the control of local officials. Nor do they change the demand for local public services, such as quality K-12 education, public safety and good roads¹.

¹ <http://cbpp.org/cms/?fa=view&id=414>

Property taxes, which account for about 50% total revenue in AA County, can increase by the Consumer Price Index (CPI) or 4.5% whichever is lower. The Pennsylvania Budget and Policy Center, *Facts About the Impact of Spending CAPS on Pennsylvania*, states²:

“ Inflation as measured by the Consumer Price Index (CPI) , typically 3 percent per year in recent years, is simply an inappropriate way to measure and control government spending. The CPI measures the increase in the cost of a “basket of goods” that a family buys: food, clothing, housing, transportation and energy. The basket of goods that a state (*or local*) government purchases—including health care, social services, transportation, prisons and education --- rises much more quickly than the CPI. In 2004, for example, the CPI was 2.8 percent, while health care premiums have routinely been rising at 10 percent or more. When some costs rise this fast, it means there is less available for other services, such as public education, higher education and other services.”

Suggestions: Run scenarios where the growth in cost of services is greater than the growth in revenues and see what happens. Past experience can be used to set ranges for service cost increases (also as noted below, revenue estimates are probably too high).

2. Current Service Levels

- With more realistic assumptions about inflation’s effects on spending compared to revenue growth, services provided to citizens would decline in the four scenarios presented if current dollar levels are maintained.
- The FIA assumes current service levels will continue into the future. This “snapshot approach” may be adequate when a short time span is considered, but over 18 years it is no longer appropriate. The justification on p. 25 of the FIA for avoiding “judgments” about service level adequacy is a copout.
- Schools are a major driver of service costs since they account for a significant share of the county budget. It would be difficult to imagine that citizens would accept schools being 20% over capacity before new schools are built as the FIA assumes. How school costs are treated in the FIA will have a dramatic effect on the profitability of new development. At 100% of capacity the “Growth Surplus” is insignificant.
- More discussion is needed about how future service requirements are projected. Going forward on a population basis alone is not sufficient. Local governments often serve expensive populations, such as, prisoners, persons with disabilities. The growth in these special populations is likely to be quite different than the growth in total population.

² <http://www.pennbpc.org/budgetwatch/budgetwatch2.php>

- Timothy W. Kelsey, *The Fiscal Impacts of Alternative Land Uses: What Do cost of Community Service Studies Really Tell Us*³?, indicates that averaging over service types can hide key distinctions between services provided to differing segments of the population and revenues received from different categories of development within a major category such as commercial and industrial.
- The backlog, is a clear indication of unmet service needs. As the population ages further needs will emerge. On-going pressures for additional educational improvements and for cleaning up our waterways also suggest increased service needs in the future. Enterprise funds have not been able to raise the necessary funds for extending sewers into the critical area—will the county have to devise an alternative future strategy. It is also not clear how well changes in service levels as population shifts occur are accounted for in the FIA.
- The fiscal impact analysis does not discuss the impacts of unfunded mandates, although new requirements are being imposed to strengthen the environment. Moreover, even before the recent downturn, the state had been considering transferring the costs of teacher retirement plans to Maryland counties. How will the county handle new mandates?

Suggestions: It is critical that spending needs be well defined over this long time period -- and that environmental costs be included. Surveys by the AA Community College have shown this is one area where taxpayers are willing to pay more for improvement.

3. Revenue Growth

On page 20-21, the FIA states that the growth in revenues is sufficient to cover the costs to serve new growth in each scenario. The FIA further notes that the property values assumed for new development are a main determinant of this result.

The FIA does not clearly differentiate what the pattern of new growth will be by category, e.g. residential, commercial industrial, open land, etc, nor the fiscal impacts associated with different patterns of growth. How new growth is distributed among these differing categories, and even by subcategories within each category, will have major impacts on future revenue generation. However, residential growth seems to be a large component of new growth and it appears to provide a net profit in the FIA analysis. If this is correct, the FIA findings are in conflict with those of many other analyses that generally show that residential development is a net fiscal loss to communities (American Farmland Trust: Fact Sheet/Cost of Community Services Studies, August 2007⁴). The American Farmland Trust in the fact sheet cited above presented findings showing that cost of service studies consistently show that revenues received from residential development do not cover the cost of services provided while for commercial and industrial development, working and open land, revenues received are much higher than

³ Journal of Community Development Society, Vol. 27, No.1, 1996.

⁴ Available for the American Farmland Trust, Farmland Information Center. (800) 370-7879.

service costs While their results present a snapshot, they do suggest that residential land development should be viewed with caution given its potential negative fiscal impacts.

The revenue projections in the FIA are too high and it is unclear whether current estimates of profit from new growth would be realized with more realistic assumptions:

- The FIA was revised to incorporate the higher impact fees but not the declines that are occurring in housing values and presumably in a few years in assessments.
- Property values are measured in 2006 at the height of the real estate market. Assessments are likely to fall over the next few years reflecting the decline in property values for existing homes and the declining price of new homes in AA County. It is not clear if past trends in property values will reemerge at any time in the near future; while it is unlikely that service costs will show commensurate declines.
- The FIA assumes that recordation and transfer taxes will remain a constant 15% of revenues. Mike Lofton (public testimony before the PAB on 5/7/2009) points out that recent County Budget Office projections for at least the next few years would be a better indicator of potential revenues from these sources.
- The FIA assumes constant State funding at existing ratios. We have recently witnessed significant declines in state aid. The Center on Budget and Policy Priorities report cited above further states: “The evidence suggests, however, that state aid is not reliably sustained over time --- particularly during economic downturns, when state aid to localities often declines.
- Increases in unemployment and declining corporate and personal and corporate income will further result in revenue declines from the piggyback tax.

Suggestion: Develop alternative revenue estimates that adequately reflect the factors discussed above.

4. Debt Service Charges

The FIA shows all capital costs included in the analysis as Pay-Go. It states on p 25 that the interest cost associated with bond financing is largely offset by the time value of money gained by the County”. It is difficult to understand how the FIA came to this assertion and no explanation is provided. Are you assuming the county invests revenues from new development and earns interest on them? The present value of these charges is unlikely to be zero. Debt service charges are real costs to the county that must be covered by revenues received --- even if the debt service will continue after the projection period in the FIA and not be fully captured. Since bond issues are used to cover capital costs associated with new development, and the county would not incur these costs without the new development, they need to be accounted for in the projections.

Suggestion: Include debt service changes.

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