3 Percent Discount Survey Memo

TO: Mike McCauley, Executive Director, League of Oregon Cities
FROM: Nick Herrera
DATE: September 7, 2012
RE: Summary of 3 Percent Discount Survey

Summary

A discontinuation of Oregon's 3 percent property tax discount would be helpful for some cities but could have potential negative impacts for others. Although the aggregate of property tax revenue would increase for all cities, five of eight cities surveyed voiced concerns about cash flow issues and questioned the benefit to be gained from eliminating the discount.

Introduction

In the summer of 2012, the League of Oregon Cities surveyed 30 cities on the cash flow impact of discontinuing the 3 percent property tax discount in favor of a new system, which would require the payment of 50 percent of the property tax bill by November 15^{th} and 50 percent to be paid by May 15^{th} the following year. Nine cities responded (30 percent response rate).

The League's survey sought information regarding how much new revenue cities might gain from the removal of the 3 percent discount, the impact on net cash flow, whether cities would be required to borrow in order to meet cash flow needs, and how much that borrowing would cost. Using a model developed by Jon Nelson, former Corvallis City Manager and consultant to the League, responding cities calculated the cost of receiving property tax at a later date than under the current system. All cities but one would see an increase in revenue, even after borrowing costs; however, the majority of responding cities expressed reservations about the impact on cash flow. Seven out of the nine respondents to the survey indicated that they would experience some cash flow impacts with the removal of the 3 percent discount.

Survey Respondents

The survey was sent to the following cities: Albany, Bandon, Canby, Corvallis, Cottage Grove, Estacada, Eugene, Fairview, Gervais, Grants Pass, Gresham, Harrisburg, Independence, John Day, Keizer, Klamath Falls, Lincoln City, McMinnville, Medford, Monmouth, Pendleton, Philomath, Redmond, Roseburg, Salem, Sandy, Sisters, Sweet Home, The Dalles, and Woodburn.

The nine cities that responded include large and small cities from a variety of regions across the state (Table 1).

Table 1: Responding Cities

Cities	Population	Region
Corvallis	54,520	Valley
Albany	50,520	Valley
McMinnville	32,270	Valley
Pendleton	16,625	Eastern
Sandy	9,780	Portland/Mt. Hood
Cottage Grove	9,745	Valley
Sweet Home	9,005	Valley

Independence	8,600	Valley
John Day	1,755	Eastern

Results: Most cities would financially benefit, but cash flow issues raise concerns

Potential new revenue varies from approximately $5,000 to $500,000, depending on the city (Table 2).

Table 2: Potential New Revenue with Elimination of Discount

City	Potential New Revenue*
Corvallis	$500,000
Albany	$468,973
McMinnville	$274,000
Pendleton	$158,000
Cottage Grove	$98,885
Sandy	$60,000
Sweet Home	$58,960
Independence	$48,254
John Day	$5,552

*Does not take into account borrowing costs for those cities that must borrow money.

Two of the nine cities (Corvallis and John Day) reported that the discontinuation of the 3 percent discount would have minimal to no impact on their cash flow, and so they would benefit by the dollar amounts in Table 2. However, such is not the case for every city. After considering borrowing needed due to the bulk of property taxes being received at a later date, the net benefit for cities is smaller.

Of the nine cities that responded to the survey, five responded that they would need to borrow money in order to meet cash flow needs. Three said they would need to revise their spending, and five would see a negative impact on their cash flow. Five cities said it would impact their reserves, and five said they would be required to borrow in order to meet cash flow needs. The five cities that would be required to borrow in order to meet cash flow needs (Albany, Cottage Grove, Independence, Pendleton and Sandy) would be required to borrow between 19.4 percent and 25 percent of their General Fund.

Table 3: Impacts on Cash Flow

City	Minimal to No Impact	Need to Revise Spending	Negative Impact	Impact on Reserves	Would Require Borrowing	Approximate % of General Fund to borrow
Albany			X	X	X	25%
Cottage Grove		X	X		X	19.4%
Independence		X	X	X	X	112%[1]
Pendleton					X	20%

[1] The City of Independence does not funnel all of their property taxes into their General Fund. Funds from the permanent rate are deposited in the General Fund, whereas funds from the GO Bond Levy and UR Debt Fund are deposited directly into their respective funds; therefore the amount of property tax Independence would need to borrow is higher than the total General Fund.

Sandy				X	X	24%
McMinnville			X	X		
Sweet Home		X	X	X		
Corvallis	X					
John Day	X					

For those five cities that would require borrowing, the benefit of the 3 percent discount is marginal. Considering an interest rate of 2 percent for borrowing, Albany's net benefit would be approximately 1.7 percent of their total general fund, Sandy and Cottage Grove benefits would each be approximately 1 percent, Independence 3.2 percent, and Pendleton's benefit would be 5.1 percent. Borrowing at 5 percent or more would have smaller benefits, and would actually cost the City of Independence $1,746 (Table 4).

Table 4: Net Benefit of 3 Percent Discount

City	Potential New Revenue	Cost of Interest at 2%	Cost of Interest at 5%	Net Benefit/Cost at 2%	Net Benefit/Cost at 5%
Albany	$468,973	$60,000	$150,000	$408,973	$318,973
Pendleton	$158,000	$31,165	$62,328	$126,835	$95,672
Cottage Grove	$98,885	$12,800	$19,964	$86,085	$78,921
Sandy	$60,000	$6,000	$15,000	$54,000	$45,000
Independence	$48,254	$20,000	$50,000	$28,254	$-1,746

McMinnville mentioned that although their revenue would increase by $274,000, this benefit would quickly be offset by a loss of interest on taxes that are currently paid in November. Concerns about cash flow were a common theme in comments made by cities. Corvallis, Cottage Grove, Sweet Home, Sandy, and Independence all commented on potential cash flow issues.

Of those cities that would need to borrow in order to cover expenditures, at least 25 percent of the remaining property tax would need to be due on Feb. 15th in order to meet cash flow requirements and avoid a short term loan, and Sandy would need as much as 100 percent to cover costs. Cottage Grove would need as little as 3 percent due on May 15th to avoid a short term loan, but Independence would need as much as 50 percent.

Table 5: Borrowing in Order to Cover Expenditures

City	Percentage of tax needed on Feb 15th	Percentage of tax needed on May 15th	Would not need a loan to cover expenditures
Sandy	100%		
Independence	50%	50%	
Cottage Grove	40-47%	3%-10%	
Pendleton	35%	15%	
Albany	25%	25%	
Corvallis			X
John Day			X
McMinnville			X
Sweet Home			X

Conclusion

The comments by respondents display some hesitancy to give up the flexibility of having money sooner rather than later. Although the aggregate of property tax revenue would increase for all cities, five of the eight cities voiced concerns about cash flow issues and questioned the benefit to be gained from eliminating the discount.

Appendix A: City Comments on the 3 Percent Discount Proposal

Corvallis

"Politically, I am fairly sure this will be a hard sell at the legislature since the R's are likely to call it a "tax increase." Realistically, I would portray it as requiring people to pay the amounts that are due. We levy a tax rate, the Assessor multiplies that by the assessed value, and the tax bill is generated. It is the amount owed for each parcel of property. While there may be some governments who benefit from the early FY cash flow, it is a matter of local government extending a loan to multiple property owners. From a pure money perspective, I wish that the law went the other way and that late payments were penalized at the same rate that interest must be paid when an appeal is held for the taxpayer -- 12%. As a final note, this change may cause locals to change how they levy for debt service. Traditional timing would be for a payment in November or December, with the second payment in May/June. If cash flow changed significantly for a fall payment, locals would likely "levy up" to collect 1.5 year's debt service payment in order to have cash on hand. This is allowed under current law -- just saying it may cause a flutter in levy amounts."

Albany

"Maybe consider reducing the discount but maintain the incentive to pay in full in November."

McMinnville

"Potential new revenue of $274,000 would be offset by loss of interest earned on taxes currently turned over in November (assuming that property taxes are distributed only in November and May as proposed). Loss of interest earned would be approximately $100,000 for a net difference of $174,000. (Under the current distribution method, approximately 86% of property taxes are turned over to the City by November 30th.) General Fund Reserve: The City of McMinnville has a Fund Balance Policy which recommends that the General Fund maintain a reserve sufficient to cover cash flows without the need for internal or external borrowing. Currently, the minimum cash reserve is $4.0 million. Under the proposed distribution method, the minimum cash reserve would be $5.5 million. The City currently has adequate General Fund reserves to meet the $5.5 million under the proposed distribution method. However, our long term fiscal forecast projects that the General Fund reserve could fall below the $5.5 million minimum by the end of fiscal year 2013-14. Internal or external borrowing could be necessary to bridge the cash flow shortfall between November and May of that fiscal year."

Sandy

"Not a high priority for us. Bond and loan payments are often structured to be due 6/30 and 12/31; it is helpful to get the majority of revenue before 12/31. This is already halfway into the fiscal year. Whether or not we actually need a loan, there is an opportunity cost in pushing back receipt of the tax revenue. Under current interest rates it's less than the discount, but it does offset savings from removal of the early payment discount."

Cottage Grove

"If assumptions are correct this could potentially be an additional $78,900 of revenue to the General Fund. However, as interest rates increase, as the market will eventually change over time, the additional amount will be reduced. It would make sense to me to charge an interest amount on the unpaid balance of the property tax owed, if not paid by the due date. For example if the first 50% of the tax is due on Nov. 15, interest would accrue on the unpaid balance after a 30 day grace period, or something of the like. Otherwise, the property owner may just wait to pay the tax at the last possible moment if there isn't any interest accruing or some type of late fee, or both. Obviously that would adversely affect the City's cash flow."

<u>Sweet Home</u>

"The City of Sweet Home receives 85% of its property taxes from the November 15 payment option. Taking off the discount and changing the payment schedule to a November and May schedule may possibly bring in an additional $58,960 in tax revenues over the 12 months, but it would reduce our cash flow by $798,939 by December 1st. I would rather have the money in the city's bank account earlier in the year than waiting until near the end of the year for what may no longer be there."

<u>Independence</u>

"This would have marginal, if any, benefit to the City of Independence ($50K). With $1M in debt service payments due every December, there is little to be gained for us. Not only would we be likely issuing TAN's each year, but the cost of issuance does not reflect the full cost to the City relative to time spent with these transactions."

<u>John Day</u>

"The extra $5,000 would be a welcome addition to our general fund; larger cities would obviously receive more benefit than the smaller cities. This legislation would not have that much impact on our city."

Appendix B: Survey Questions

1. Estimate the impact of discontinuing the current property tax for your city, using one of the two methods listed below. For the purposes of this survey either method is acceptable.

Potential new revenue: $_________________

Method 1: Determine your city's % share of property taxes collected by the county for FY 2010-11 (see *Principal Distribution Schedule* county report) times the total amount of discounts (see *Summary of Property Tax Collections* county report).

Method 2: A second but less precise method - take the discount value that has been calculated by the State Legislative Revenue Office on a statewide basis (2.45 %) times property taxes collected in FY2010-11 (ex. 2.45 % X $20 million = $490,000).

Please indicate which method you used for this calculation.
Note: Questions 2-4 assume legislation similar to HB 3167 is considered for the 2013 session.

2. If taxes were distributed 50% on November 15th and the remaining 50% distributed in May of the following year, generally what impact would it have on your cash flow? (Please select all that apply).

___ Minimal to no impact
___ Need to revise spending
___ Negative impact on cash flow
___ It would impact reserves
___ It would require borrowing to meet cash flow need
(If borrowing is required: What approximate percentage of your general fund?____%)

3. If your city had to borrow to meet cash flow needs under the changed distribution, estimate the net cost of cash flow loan(s). (Net assumes some of the cost may be reduced through short term earnings on the loan.)

Note: This would be in addition to any borrowing your city currently does under the present tax collection system.

Estimated Principal Amount in excess of ordinary or historic borrowing: $______________

Cost of loan(s) at 2% (favorable tax anticipation notes rates):
$______________

Cost of loan(s) at 5% (less favorable tax anticipation notes rates):
$_____________

___ No money would need to be borrowed

4. If your city would require a loan to cover expenditures in the event of 50% property tax payment due November 15th, please indicate what percentages of the remaining property tax would need to be due on the following February 15th and May 15th tax payment dates to meet existing cash flow requirements without a short term loan:

Feb 15th _______ %

May 15th _______%

____ Would not need a loan to cover expenditures

5. What is your personal opinion on the benefits and costs of pursuing legislation to end the property tax discounts?

____
____
____
____